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FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING—Part 2

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND COMMERCE HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE GOVERNMENT'S ROLE IN PREVENTING CONTRACTOR ABUSE

APRIL 23 AND 24, 1985

Serial No. 99–50

Printed for the use of the Committee on Energy and Commerce

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(III)

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FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING

TUESDAY, APRIL 23, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Oversight and Investigations,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2322, Rayburn House Office Building, Hon. John D. Dingell (chairman) presiding.

Mr. Dingell. The subcommittee will come to order.

Under rules X and XI of the House of Representatives, the Committee on Energy and Commerce has the responsibility for the Federal securities laws and therefore oversight of the Securities and Exchange Commission. The committee and its Subcommittee on Oversight and Investigations are charged with reviewing, and I quote, "on a continuing basis" the administration of these laws to assure they are adequate in their substance and their enforcement.

In two previous hearings in February and March, the subcommittee dealt with questions of false books and records, questionable accounting practices, improper billings, potential stock manipulations, false SEC filings, incomplete stockholder reports, and possible violations of the Foreign Corrupt Practices Act by a major defense contractor, General Dynamics.

In subsequent hearings on a number of matters, the subcommittee has found a number of questions relative to accounting practices which effect not only shareholders rights, but raises questions about the administration of Federal laws and the impact on these Federal laws by actions of the accounting profession.

Today, the subcommittee continues its inquiry. The subcommittee will focus on testimony of similar practices by Pratt & Whitney, a division of United Technologies Corporation.

The securities of both companies are listed and traded on the New York Stock Exchange and also on various regional stock exchanges, and therefore are subject to the reporting requirements of the Securities and Exchange Commission and requirements of Federal law relative thereto. The jurisdictional issues that the subcommittee dealt with in earlier hearings are equally applicable to the hearings today and tomorrow.

The subcommittee has been reviewing the different and often conflicting accounting rules and regulations promulgated by Federal agencies in light of the 1975 amendments to the Federal securities laws. At our request, the General Accounting Office has been conducting an extensive review of the accounting rules and previously has testified about some conflicts in these rules. Clearly, Cost Accounting Standard 405, which relates to defense contractor accounting practices, is included in that review.

In announcing his actions to recover $244 million from General Dynamics for overhead mischarges, highlighted in the subcommittee hearings, Secretary of Defense Weinberger claimed that General Dynamics was an aberration. Today and tomorrow, the subcommittee will expect to hear testimony and see evidence that far from being an aberration, the company was just one of the gang. False reports and false claims, incomplete records and an unfortunate attitude of "catch me if you can" seem to be standard operating procedures for major defense contractors. The cost of these things to the taxpayers is, of course, immense.

Several days after the subcommittee disclosed serious mischarges against the Government for obviously unallowable overhead expenses, including the boarding of this nation's most famous dog, Furston, Secretary Weinberger announced his new get-tough policy. His first action was to require all defense contractors to certify, under penalty of perjury, to the allowability and reasonableness of overhead charges at the various steps.

The major defense contractors complained. Immediately, the Department of Defense General Counsel advised the contractors that the Pentagon was really not considering criminally prosecuting fraudulent certifications. More contractors continued to complain. So a Deputy Under Secretary further softened the blow for the contractors, so that they would only have had to certify their overhead charges at final settlement. These steps, of course, eliminated any benefit the taxpayers might have gotten as a result of the certification requirement.

If it were not so tragically expensive, it would be amusing to watch the Pentagon react to one scandal after another. It is a joke. The violations of the submarine contracts of Electric Boat led to Secretary Lehman setting up a gratuities board to investigate General Dynamics. He turned around and gave General Dynamics a couple of billion dollars more in submarine contracts the next day.

The Air Force suspended General Electric from any further government contracts after they were indicted for defrauding the Government. A few days later, the Air Force awarded another contract to the very division that had committed the fraud, claiming that national security was at stake. About a month later, the Air Force lifted the suspension of the corporation, after they promised not to defraud the Government again. What kind of deterrence, one must ask, is this?

This subcommittee, using extremely limited resources, has found a number of glaring examples of problems to be covered in hearings today and tomorrow. The subcommittee will highlight the ineffectiveness or the collapse of the entire defense acquisition system, based unfortunately upon the most curious accounting practices and principles.

The subcommittee has asked the Securities and Exchange Commission to inquire into potential securities laws violations by General Dynamics. It may well be that this inquiry will have to be expanded to include other defense contractors.

The subcommittee announces that our first witness is Mr. James Cavanaugh, special agent, Federal Bureau of Investigation, West Palm Beach Resident Agency, Miami Division, Post Office Box 3389, West Palm Beach, FL 33402.

The Chair will inquire whether there are opening statements.

The gentleman from Oregon.

Mr. WYDEN. Thank you very much, Mr. Chairman.

Just very briefly, I want to commend you for your tenacity with respect to this investigation. I think when history looks back at this period they are going to marvel at how Chairman Dingell and a handful of his investigators were able to do what 3,400 auditors at the DCAA could not do, and that is, expose an unprecedented ripoff of hundreds of millions of tax dollars through unauthorized billings that have absolutely no relation to our real defense needs.

The fact is, the defense acquisition system today is incapable of stopping wholesale ripoffs of the taxpayers. What we see are nonexistent cost controls, sloppy auditing, phoney debarments, and bureaucratic paralysis.

The overhead accounts in defense contracts concern me in particular, and it is my view that they have evolved into gigantic Government slushfunds.

What we are seeing is that these overhead accounts are used to throw virtually everything in but the kitchen sink. I think what also concerns me, Mr. Chairman, is that we see—and we're going to see specifically today a larger Government-wide game plan to preserve the status quo.

For the life of me, I can't figure out why the Justice Department has not brought actions in this case, and it seems to me very stark evidence again that the system has broken down in virtually every respect.

Last summer, in addition, Mr. Chairman, the Pentagon IG predicted criminal indictments of at least 15 major defense contractors by the fall—good solid cases, in his words—yet there were no indictments last fall, and we have seen virtually no action today.

The last point that I would make, Mr. Chairman, deals with Mr. Weinberger's get-tough policy. What we saw is, that policy lasted only a few days, and I see no evidence that these get-tough policies of the Pentagon are going to have a shelf life of more than 30 days. So we are going to have to take some steps to turn this system around. It is quite simply out of control. And in my view, Mr. Chairman, because of your leadership, we are going to be able to bring these shenanigans to an end in this Congress.

Thank you.

Mr. DINGELL. The Chair thanks the gentleman.

The gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

Let me first say, Mr. Chairman, that the matters we will examine today are most serious. I am not about to praise or condemn anyone before the facts are fully known, and it's critical, Mr. Chairman, that we all remain objective and open minded. But we must recognize from the start that all employees of the Federal Government and all private contractors to the Government have a special responsibility to avoid waste of the taxpayer's dollar.

Anytime allegations of significant abuse arise, these allegations must be thoroughly examined. I think we must never forget that for every bill the Government receives, there is a payor, and he or she is the American taxpayer.

Second, I would hope that we can proceed today in a reasoned and thorough matter to determine, or at least project, the real underlying causes for any proven contract abuse. It seems to me that this should always be the focus of our endeavor.

We need to find out what the problems are, Mr. Chairman, and the problems that exist in the procurement system and what solutions are possible and feasible. This may seem to be a rather obvious statement; however, I think there is a normal tendency to concentrate on the most disruptive facts and the most shocking news and the most attention-grabbing headlines to the exclusion of other factors. I think there is an inclination to gloss over the deeper roots of the process which created the abuse in the first place.

I know this subcommittee has always attempted to operate in a thorough manner in the past, and I am confident that it will proceed in a similar fashion today.

Mine is a relatively simple concern that we not ignore the forest for the trees, but I think it has broad implications. We must determine whether we have uncovered isolated cases of alleged abuse, or whether there are symptomatic problems in our procurement system.

In sum, I think we need to review this situation to the full extent of our committee's jurisdiction. We need to find out where any problems are, whether they be in the law, the administrative rules, or in the actions of specific Government organizations or individuals. I feel we need to get the facts and get to the bottom of this matter without losing our perspective of the whole, and without forgetting who in the end pays the bills for the operation of our Government.

Thank you, Mr. Chairman.

Mr. Dingell. The Chair commends the gentleman for a very statesmanlike statement, and the Chair assures the subcommittee that the concerns of the gentleman from Florida will be well in the mind of the Chair as we proceed because I happen to concur in the sentiments which he has expressed.

The gentleman from Minnesota.

Mr. Sikorski. Thank you, Mr. Chairman.

Last year we paid General Dynamics $7.2 billion, and now we know that in the last few years, hundreds of millions of America's taxpayers' dollars went for bailouts, diamonds, country club memberships, and the like. Defense Secretary Weinberger said after the subcommittee uncovered those abuses that General Dynamics was an aberration, just one bad apple.

Our witnesses today, however, tell an incredible story of industry and Government coverups of widespread fraud.

Our first witness found that Pratt & Whitney had overcharged the Government millions. They had billed us for Pratt & Whitney emblazoned Gucci bags for extravagant parties, and even for trips to Pago-Pago.

Mr. Secretary, the litany sounds familiar. It includes fishing and golfing trips for generals, blank vouchers, luxury foreign cars, double-charging revolving doors, $500 ice sculptures, strolling minstrels, 5,000 baseball caps, and 300 rose corsages for the Fighter Fling Ball. Yet, when loyal Americans question the wisdom of unending administration requests for billions for more defense, they are called unpatriotic.

Well, it is not unpatriotic to expose waste and fraud in our Government's defense programs and insist it end. Instead, we should question the sincerity of cold war profiteers who wave the flag at the same time they pick our pockets.

Perhaps equally amazing is that the Defense Department lets these defense contractors get away with it. Despite the efforts of conscientious auditors like George Spanton at DCAA, the Department literally commends defense contractors like General Dynamics and Pratt & Whitney after their fraud has been exposed.

Today Mr. Spanton will tell us about an investigation he began in 1982. He uncovered waste and fraud, and what was done. Pratt & Whitney was given larger contracts and more tax dollars, and Mr. Spanton's bosses rewarded his diligence by threatening to fire him and then subjecting him to criminal investigation.

In fact, DCAA not only refused to help Mr. Spanton secure the Pratt & Whitney documents that he needed to complete his case; they buried the information he did find.

Aggressive investigators at the FBI were equally frustrated in their efforts to bring Pratt & Whitney to task for their criminal activities. Nearly a year after the FBI completed its investigation, a U.S. attorney in Miami still refuses to move the case forward, and the GAO tells us how contract officers routinely allow wholly unallowable expenses.

The stories we will hear today are incredible, but the evidence is clear. Some defense contractors are bleeding the American taxpayers dry, and the Departments of Defense and Justice are helping them do it.

No, Mr. Secretary, General Dynamics is not an aberration. It is not just one bad apple. We have got a whole apple orchard. And Americans who believe in mom and apple pie are fed up with it.

Thank you, Mr. Chairman.

Mr. DINGELL. The Chair thanks the gentleman.

The gentleman from New York, Mr. Eckert, is recognized.

Mr. ECKERT. Mr. Chairman, today we consider the testimony of several who allege that there have been improper billing procedures on the part of Pratt & Whitney. The hearings today and tomorrow have larger implications for Congress' general inquiry into the defense procurement process.

It is my hope that these hearings be directed toward strengthening our national defense by examining those factors that prevent our receiving maximum benefit for each defense dollar spent and pointing the way to improvements.

It is my hope also that these hearings will not become a forum for deprecating our Defense Establishment in general terms and that they will instead be constructive and show the Congress and the American people how, together, we can get a better defense for less cost.

Mr. DINGELL.

The Chair thanks the gentleman.

The Chair announces that our first witness today will be Mr. James Cavanaugh.

Mr. Cavanaugh, you are a very respected member of a particularly respected institution, and we welcome you today.

The Chair does make some initial comments preparatory to recognizing you for your statement. In 1982, Mr. Cavanaugh began an investigation of the Pratt & Whitney Government Products Division of United Technologies Corp. for fraud against the Government, generally for mischarges against the Government in Pratt & Whiteney overhead accounts.

Some of these mischarges were identified by the DCAA resident auditor at Pratt & Whitney. During the 2-year investigation, the FBI obtained numerous documents from Pratt & Whitney and interviewed many witnesses from Pratt & Whitney, UTC and the Government.

Ultimately, a grand jury was convened, and extensive evidence and testimony had been developed.

It is not the purpose of this subcommittee today to intrude either into the proceedings, the papers, the records or the actions of the grand jury, nor is it the intent of the subcomittee to go into the conduct of the investigation.

The Chair will note that this is a most comprehensive investigation which is being conducted of fraudulent charges against the Government. From what we have been able to determine about the findings of the investigation, Pratt & Whitney engaged in many of the same activities as General Dynamics that the subcommittee has already explored in considerable detail.

It appears that this is simply another incident of strong evidence of what is clearly a systemic problem, and Mr. Cavanaugh should have as good an understanding of the problem as anyone at this particular time. That is why his testimony is important to the subcommittee's investigation.

The FBI concluded their 2-year investigation in the summer of 1984, about 1 year ago. The U.S. attorney and Department of Justice have stated that there is still an active investigation under way, and I commend them for that and I wish them success in that undertaking. The grand jury is still considering potential indictments.

This gives all of us on the committee considerable comfort. Although we are sensitive to that problem, the subcommittee today still believes that Mr. Cavanaugh's testimony is of overriding importance to the committee's inquiry as set out in the opening statement of the Chair. Therefore, the subcommittee will hear Mr. Cavanaugh's testimony but the Chair will instruct him that he should limit his testimony to what may be required to comply with the provision of rule 6(e) of the Federal Rules of Criminal Procedure.

Mr. Cavanaugh, we are pleased you are with us. The Chair has certain preparatory comments to make prior to the time that you are recognized for a statement.

First of all, you are here under subpoena; is that correct?

Mr. CAVANAUGH. That is correct, sir.

Mr. DINGELL. You are not here, then, voluntarily?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. I want to make that clear, not that you have been uncooperative with the committee but rather to establish for the record without any question that you are here by a compulsory process of the committee, and I reiterate again that that creates no inference of any lack of propriety or proper behavior on your part, but simply that the statement is made so the record will be clear and so that you will have the necessary protection about your appearance before the committee and any other place.

Mr. Cavanaugh, do you object to testifying under oath today?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. Do you desire to have legal counsel with you to advise you on your rights or the limitations on the powers of the committee at the table during your appearance?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. It is your right to do so.

The Chair will observe that copies of the rules of the committee and rules of the subcommittee and rules of the House are there at the table before you to inform you of your rights. If you have any questions with regard to the behavior of the committee, you may feel free to insert them at any time that you deem appropriate.

The Chair notes that you have an associate here with you at the table. Sir, if you would identify yourself at this time, please.

Mr. MOSCHELLA. My name is Emil Moschella, Legislative Counsel of the FBI.

Mr. DINGELL. Mr. Moschella, you have the approval of the Chair and the subcommittee to be here. Would you define, however, the capacity in which you choose to be present?

Mr. MOSCHELLA. Simply to assist Mr. Cavanaugh in responding to your questions, Mr. Chairman.

Mr. DINGELL. The Chair will then treat you as appearing in the capacity of his counsel. I believe that will be appropriate. I am sure you understand the rights and duties of counsel, and I will not instruct you further on them at this particular time.

You will, therefore, not be sworn. Your name will be noted in the record as having appeared here in the capacity in which you do appear, and the Chair will advise that you and Mr. Cavanaugh will be treated with every courtesy this morning.

[Witness sworn.]

Mr. DINGELL. You may consider yourself to be under oath, and you are recognized for such statement as you choose to give. The Chair has to run over and vote, and I will be back as quickly as possible.

TESTIMONY OF JAMES CAVANAUGH, SPECIAL AGENT, FEDERAL BUREAU OF INVESTIGATION, MIAMI DIVISION, ACCOMPANIED BY EMIL MOSCHELLA, COUNSEL

Mr. CAVANAUGH. Thank you. I am here in response to a subpoena issued by the committee requesting me to testify in connection with a criminal investigation which is pending before a Federal grand jury in the southern district of Florida.

Since this is a pending investigation, I have not been authorized to testify concerning the substance of the investigation, nor am I authorized to respond to questions concerning FBI policy. Additionally, I have no authority to release FBI documents.

Further, rule 6(e) of the Federal Rules of Criminal Procedure prohibits me from testifying concerning matters occurring before the grand jury.

Within these limitations, I will be pleased to respond to your questions.

Mr. WYDEN [presiding]. Please proceed.

When were the allegations about fraudulent claims against the Government by Pratt & Whitney first brought to your attention, Mr. Cavanaugh?

Mr. CAVANAUGH. During October 1982.

Mr. WYDEN. When did the FBI start the investigation?

Mr. CAVANAUGH. October 1982.

Mr. WYDEN. What was the date of the first document subpoena?

Mr. CAVANAUGH. I don't understand the question, sir.

Mr. WYDEN. What was the date of the first document subpoena to Pratt & Whitney?

Mr. CAVANAUGH. I am unauthorized to disclose any information concerning that, sir.

Mr. WYDEN. For the production of documents?

Mr. CAVANAUGH. Yes, sir.

Mr. WYDEN. You are not authorized to answer that question?

Mr. CAVANAUGH. No, sir.

Mr. WYDEN. What were the dates and number of witnesses brought before the grand jury?

Mr. CAVANAUGH. Respectfully, sir, I am not authorized to disclose that information.

Mr. WYDEN. Please tell us the number of interviews—what is the authority for that? Are you basing that on the 6(e) provision?

Mr. CAVANAUGH. Yes, sir.

Mr. WYDEN. Please tell us the number of interviews conducted by the FBI in this matter.

Mr. CAVANAUGH. On the total investigation, sir?

Mr. WYDEN. Please.

Mr. CAVANAUGH. It pertains to the investigation itself. I don't believe I can answer that. I'm not authorized to disclose it.

Mr. WYDEN. There were certain interviews, certainly, outside of the 6(e) provision?

Mr. CAVANAUGH. Yes, there would be interviews.

Mr. WYDEN. And how many of those were there?

Mr. CAVANAUGH. I don't have a number, sir.

Mr. WYDEN. On what date did the FBI conclude the investigation?

Mr. CAVANAUGH. It was essentially completed in the summer of 1984.

Mr. WYDEN. Please clarify what is and what is not covered by 6(e) of the Rules of Criminal Procedure.

Mr. CAVANAUGH. I would have to get with my headquarters to get a determination on something like that, sir.

Mr. WYDEN. How about from the standpoint of the 302 interviews? Which are classified 6(e) and which are not?

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Mr. CAVANAUGH. Sir, I'm not authorized to testify concerning the substance of the investigation or respond to questions pertaining to policy.

Mr. WYDEN. So that would be true as well of the letterhead memorandum, then, the prosecution memos?

Mr. CAVANAUGH. Yes, sir, as far as I understand.

Mr. WYDEN. When you interviewed somebody who was outside of the grand jury, however, that is outside of 6(e)? That is what we would like to discuss with you today.

Mr. CAVANAUGH. Yes, sir, but I have not been authorized to testify concerning the substance of the investigation.

Mr. WYDEN. You have been subpoenaed, of course.

Mr. CAVANAUGH. Yes, sir.

Mr. WYDEN. And we believe you are required to discuss this information when under subpoena.

Mr. CAVANAUGH. I know that, sir, and I respectfully submit that I have not been authorized to disclose it.

Mr. WYDEN. Were you instructed not to discuss these matters?

Mr. CAVANAUGH. Yes.

Mr. WYDEN. By whom?

Mr. CAVANAUGH. The Assistant Director, Oliver Revell.

Mr. WYDEN. I couldn't quite hear it.

Mr. CAVANAUGH. Assistant Director Oliver Revell.

Mr. WYDEN. And what, specifically, were his instructions to you?

Mr. CAVANAUGH. That I am not authorized to respond to the substance of the investigation nor authorized to respond to questions concerning FBI policy.

Mr. WYDEN. He forbade you from answering, in other words?

Mr. CAVANAUGH. I have to be authorized. I am not authorized.

Mr. WYDEN. When were you so instructed, Mr. Cavanaugh?

Mr. CAVANAUGH. This morning.

Mr. WYDEN. What statutory authority was given for these instructions?

Mr. CAVANAUGH. I'm sorry, sir. I would have to get clarification from headquarters on the statutory authority.

Mr. WYDEN. But he must have given you some legal authority for refusing to be able to discuss these matters.

Mr. CAVANAUGH. I would have to get clarification from headquarters, sir.

Mr. WYDEN. What was the role of George Spanton and the DCAA in this investigation?

Mr. CAVANAUGH. Mr. Spanton was the head auditor at the Pratt & Whitney Government Products Division during the time of this investigation until his retirement.

Mr. WYDEN. Did DCAA have access to documents at Pratt & Whitney?

Mr. CAVANAUGH. Again, I would respectfully decline to answer that one because it's getting into the substance of the investigations.

Mr. WYDEN. Would you please list the ten most serious cases of suspected fraud that the FBI investigation focused on?

Mr. CAVANAUGH. I have not been authorized to disclose that, sir.

Mr. WYDEN. How about if we start with General Edwards' solicitation of the $67,500 contribution to the art center? That was in the newspaper.

Mr. CAVANAUGH. I have no authorization to discuss that, sir.

Mr. WYDEN. Are you familiar with it?

Mr. CAVANAUGH. Yes, I am familiar with the newspaper article.

Mr. WYDEN. Have you investigated it personally?

Mr. CAVANAUGH. I'm not authorized to discuss that part. There is a pending criminal investigation.

Mr. WYDEN. Would you please list the cases of suspected fraud that you can't discuss today because of rule 6(e)?

Mr. CAVANAUGH. I don't believe I could do that, sir. To do so may jeopardize an ongoing investigation, and I'm also operating under the rule 6(e) of the Federal grand jury.

Mr. WYDEN. But there are some items here that are outside of 6(e). Those are what we wish to discuss with you. Could you itemize those matters which you can discuss because they are outside of 6(e)? Otherwise, this may be a fairly long morning, and I would like to save your time.

Mr. CAVANAUGH. I know, sir, and I appreciate it, but I have not been authorized to disclose it. I cannot discuss the substance of the investigation or the policy.

Mr. WYDEN. Have you been barred from discussing these matters that are outside 6(e) as well?

Mr. CAVANAUGH. Prior to discussion of same, I would have to be authorized. I have no authorization to discuss it.

Mr. WYDEN. Please describe the problems with DCAA audits, attitude and access to records at each level of the DCAA organization, that you can speak on generically.

Mr. CAVANAUGH. Generically, probably, but it would probably be better answered by Mr. Spanton since he was the auditor.

Mr. WYDEN. But I asked the question of you, and it is certainly pertinent to your investigation.

Mr. CAVANAUGH. That's what I mean. It's pertinent to the investigation, so therefore it is an integral part of it.

Mr. WYDEN. But it can be answered, again, without running afoul of the 6(e) problem?

Mr. CAVANAUGH. I don't believe so, sir. Based on my knowledge of the case, I don't think it can be.

Mr. WYDEN. How about describing the problems with the AFPRO's, their attitudes, their relationship with the contractors.

Mr. CAVANAUGH. Again, that would be an integral part of the criminal investigation, sir.

Mr. WYDEN. Is it true that three consecutive NAVPRO's and AFPRO's went to work for Pratt & Whitney immediately upon retirement from the armed services?

Mr. CAVANAUGH. I'm not authorized to discuss that, sir, or testify concerning it.

Mr. WYDEN. We would like to know about an interview that you had with Mike Price, a former NAVPRO. Could you discuss that? He was not identified by the grand jury, Mr. Cavanaugh.

Mr. CAVANAUGH. It is still not authorized, sir. I can't go into that.

Mr. **Wyden**. You can't discuss the substance of that particular interview even though it had no connection with the 6(e) matter?

Mr. **Cavanaugh**. No, sir. I have not been authorized to testify concerning it.

Mr. **Wyden**. Why would the AFPRO's want to get tough on the contractors' overhead when they are going to become a part of that overhead in a few years? Another generic kind of question.

Mr. **Cavanaugh**. It would be more aptly directed to the AFPRO's or the NAVPRO's in the case.

Mr. **Wyden**. But again, you have conducted a lengthy investigation of this matter, and we would like to have your response to the question.

Mr. **Cavanaugh**. Yes, sir, but I have not been authorized by headquarters to testify concerning the substance of the investigation.

Mr. **Wyden**. And again, just so the record is clear, you have no legal authority for your refusal to discuss these matters.

Mr. **Cavanaugh**. No, sir. I said I am not aware of it. It would have to be clarified through FBI headquarters.

Mr. **Wyden**. Just out of curiosity, I should think you would want to know the legal authority before you came down here. You are the one who was subpoenaed. You didn't ask for the legal authority?

Mr. **Cavanaugh**. No, sir.

Mr. **Wyden**. In hindsight, do you think you should have?

Mr. **Cavanaugh**. Not necessarily, because I am prohibited from discussing any pending or ongoing investigation. In this case it falls into that category as far as I have been instructed.

Mr. **Wyden**. Even if there is no legal authority for those instructions, you should still come down here and refuse to discuss them?

Mr. **Cavanaugh**. I still have to stand on what we have been told. I am not authorized to testify concerning this, sir.

Mr. **Wyden**. Do the contracting officers cause problems with the prosecutability of some of these cases?

Mr. **Cavanaugh**. I couldn't testify because it is an integral part of the investigation, sir, and it is ongoing.

Mr. **Wyden**. Would you please discuss the letter from a contracting officer to Pratt & Whitney approving the Carrier air-conditioning rebates?

Mr. **Cavanaugh**. No, sir, I cannot. I respectfully decline because I'm not authorized to discuss that.

Mr. **Wyden**. Is this complicity on the part of a governmental official?

Mr. **Cavanaugh**. I'm not authorized to discuss that at all, sir.

Mr. **Wyden**. What problem has it caused for the prosecution?

Mr. **Cavanaugh**. As far as the prosecutability of it, it might better be asked of the U.S. Attorney's Office.

Mr. **Wyden**. Again, we have asked it of you. Are you saying that this is, again, under your specific instructions not to discuss?

Mr. **Cavanaugh**. That is correct, sir.

Mr. **Wyden**. Why didn't the assistant U.S. attorney simply expand his investigation and target the governmental official?

Mr. **Cavanaugh**. I cannot answer that, sir.

Mr. **Wyden**. Could you discuss problems with the DAR?

Mr. **Cavanaugh**. The ambiguities of it, you mean?

Mr. **Wyden**. Sure. Defense acquisition regulations.

Mr. **Cavanaugh**. I don't believe so, sir, because of the bearing it would have on any possible or potential prosecution. I can't say what is going to happen.

Mr. **Wyden**. Please discuss the tenure and the attitude of the various assistant U.S. attorneys who have been assigned to this *Pratt & Whitney* case.

Mr. **Cavanaugh**. The only area that I could touch on would be that we have had several assistant U.S. attorneys on this matter, dating back to 1982, and they have been with it since the inception.

Mr. **Wyden**. Why was the assistant U.S. attorney in Palm Beach, Karen Atkinson, taken off the Pratt & Whitney fraud case?

Mr. **Cavanaugh**. I have no idea, sir. You would have to clarify that with the U.S. Attorney's Office.

Mr. **Wyden**. Why was Mr. Sullivan assigned to the case and then taken off it?

Mr. **Cavanaugh**. That would be a decision inside the U.S. Attorney's Office, which I would have no knowledge of.

Mr. **Wyden**. When was Mr. Kozar assigned to the case?

Mr. **Cavanaugh**. In 1984.

Mr. **Wyden**. Why would it take 3 years for a prosecutor to determine whether they can go forward with indictments?

Mr. **Cavanaugh**. I'm not an attorney. You would have to clarify that question with the U.S. Attorney's Office, sir.

Mr. **Wyden**. But tell us what you think. Isn't that a sign of foot dragging? Isn't that pretty much stalling in every sense of the word?

Mr. **Cavanaugh**. I'm not able to give you an opinion because each case would have to stand on its own merits.

Mr. **Wyden**. But how could it be other than stalling? Give me a possible explanation for anything else other than just stalling, foot dragging, and trying to drag out a process that is ready to go in every respect.

Mr. **Cavanaugh**. Again, I'm not qualified to answer that.

Mr. **Wyden**. When was Mr. Kozar assigned to the case?

Mr. **Cavanaugh**. Sometime in 1984.

Mr. **Wyden**. July?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Wyden**. Why would it take a prosecutor an entire year after the FBI completed their investigation to determine whether they are able to prosecute the case?

Mr. **Cavanaugh**. I do not know, sir. The question may be better directed towards the U.S. Attorney's Office.

Mr. **Wyden**. I understand that you have had problems in your investigation pinpointing the responsibility within Pratt & Whitney as to who made the decisions to charge these bizarre and unallowable overhead expenses to the Government. We found that in the case of General Dynamics and their internal directives and procedures for not charging these unallowable expenses to the Government. Even Cost Accounting Standard 405 goes to this point. Doesn't Pratt & Whitney have a similar directive?

Mr. **Cavanaugh**. I would be unable to comment on that, sir. I'm unauthorized to testify concerning the substance of the investigation.

Mr. **Wyden**. But somebody must have made the decision inside the corporation. Isn't that right?

Mr. **Cavanaugh**. Again, I could not comment on that, sir.

Mr. **Wyden**. But again, how could it be otherwise? Somebody must have made the decision inside the corporation.

Mr. **Cavanaugh**. I don't know, sir. You would have to direct that to Pratt & Whitney.

Mr. **Wyden**. Then, if it is difficult to sustain a prosecution of individuals at Pratt & Whitney who are responsible for these fraudulent charges, why wasn't the corporation indicted? Why haven't they been indicted?

Mr. **Cavanaugh**. I do not know, sir. You would have to ask that of the U.S. attorney.

Mr. **Wyden**. I can only say that I think this is an absurd situation in every respect. What we have is a very, very clear case. I understand the U.S. attorney has argued that if they indict Pratt & Whitney, the corporation would then be debarred from Government contracting, and then we have this absolutely bizarre argument that the Government would be unable to get jet engines for the F-16 fighters. I just think this is an outrageous situation.

I think this is a situation where the contractors literally have the Government and the taxpayers over a barrel, and I think it is very, very unfortunate that your superiors told you to come down here and refuse to give us information that is central to trying to clean this mess up.

Thank you, Mr. Chairman.

Mr. **Dingell**. The time of the gentleman has expired.

The gentleman from Florida.

No, the Chair is going to recognize himself here.

Mr. Cavanaugh, have you been instructed by your superiors or by any other person that you are not to testify today?

Mr. **Cavanaugh**. No, sir.

Mr. **Dingell**. Have you had any discussion with your superiors or with officers of the Department of Justice about your appearance here today?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Dingell**. With whom did you have those discussions?

Mr. **Cavanaugh**. Quite a number of people.

Mr. **Dingell**. Please name the people with whom you had discussions?

Mr. **Cavanaugh**. Under the direction of Assistant Director Oliver Revell, who gave me my specific instruction.

Mr. **Dingell**. He gave you specific instructions?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Dingell**. What were those instructions?

Mr. **Cavanaugh**. That I'm not authorized to testify concerning the substance of the investigation, nor am I authorized to respond to questions concerning FBI policy.

Mr. **Dingell**. You are or are not?

Mr. **Cavanaugh**. I am not.

Mr. **Dingell**. You are not. All right.

Mr. CAVANAUGH. And I have no authority to release any FBI documents as I am not the custodian of records. Other than that, to tell the truth and answer your questions to the extent possible.

Mr. DINGELL. Let me read to you section 192 of title II of the United States Code. It reads as follows: "Refusal of witness to testify or to produce papers." The language of the section is as follows:

> Every person who, having been summoned as a witness by the authority of either House of Congress to give testimony or to produce papers upon any matter under inquiry before either House, or any joint committee established by a joint or concurrent resolution of the two Houses of Congress, or any committee of either House of Congress, willfully makes default, or who, having appeared, refuses to answer any question pertinent to the question under inquiry, shall be deemed guilty of a misdemeanor, punishable by a fine of not more than $1,000 nor less than $100 and imprisonment in a common jail for not less than one month nor more than twelve months.

I want you to have that statute clearly in your mind as you appear before the committee today.

I also would like to read to you title 18, section 1505. This is entitled, "Obstruction of proceedings before departments, agencies, and committees":

> Whoever, with intent to avoid, evade, prevent or obstruct compliance, in whole or in part, with any civil investigative demand duly and properly made under the Antitrust Civil Process Act, willfully withholds, misrepresents, removes from any place, conceals, covers up, destroys, mutilates, alters, or by any other means falsifies any documentary material, answers to written interrogatories or oral testimony, which is the subject of such demand; or attempts to do so or solicits another to do so; or whoever corruptly, or by threats or force, or by any threatening letter or communication influences, obstructs, or impedes or endeavors to influence, obstruct or impede the due and proper administration of the law under which any pending proceeding is being had before any department or agency of the United States, or the due and proper exercise of the power of inquiry under which any inquiry or investigation is being had by either House, or any committee of either House or any joint committee of the Congress—shall be fined not more than $5,000 or imprisoned not more than 5 years, or both.

I read these to you so that you will have had a full appreciation of the powers of the subcommittee and the duties and responsibilities of witnesses who appear here before this particular body. It is my hope that this reading will be of assistance both to you and to the other officers of the Department of Justice who might be interested in your appearance here today, and also of assistance to the committee in connection with this inquiry at this time.

Now, who else has spoken to you about your appearance here today, if you please?

Mr. CAVANAUGH. Sir, I couldn't even tell you the number of names. I honestly can't. I have been authorized to answer within the limitations set forth in my opening statement, and that is all they authorized me to do.

Mr. DINGELL. I am aware of that. Who was it that told you that?

Mr. CAVANAUGH. Assistant Director Oliver Revell.

Mr. DINGELL. At what time?

Mr. CAVANAUGH. Nine o'clock this morning.

Mr. DINGELL. Nine o'clock this morning?

Mr. CAVANAUGH. Yes, sir. Yes, sir.

Mr. DINGELL. Where did that take place?

Mr. CAVANAUGH. At FBI headquarters. He is the highest ranking officer I have spoken to at the headquarters.

Mr. DINGELL. Has anyone else ever spoken to you with regard to your appearance here, expressing any limitations on your power to testify or any instructions with regard to your comments or appearance before this committee?

Mr. CAVANAUGH. No, sir. Mr. Revell is the final authority.

Mr. DINGELL. I recognize that. Who else in the Department has done this?

Mr. CAVANAUGH. I have spoken with a number of people since yesterday, sir, legal counsel.

Mr. DINGELL. Since yesterday? Who were they, please?

Mr. CAVANAUGH. I can't give you everybody's name.

Mr. DINGELL. Well, your best efforts will be appreciated.

Mr. CAVANAUGH. Mr. Helterhoff.

Mr. DINGELL. Helterhoff?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. Who else?

Mr. CAVANAUGH. Well, you caught me off guard on that one. I can't give you the names. I really can't. It all stopped with Mr. Revell because he is the Assistant——

Mr. DINGELL. What did Mr. Helterhoff instruct you to do?

Mr. CAVANAUGH. Tell the truth and, basically, come here and cooperate to the extent we are able to.

Mr. DINGELL. When did that occur?

Mr. CAVANAUGH. Throughout yesterday and today, sir.

Mr. DINGELL. Yesterday?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. Approximately what time?

Mr. CAVANAUGH. I cannot give you a specific time. I was there all day yesterday at headquarters.

Mr. DINGELL. OK. Can you cite the statutory authority which was used to instruct you with regard to what you were to testify before this proceeding today?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. Was any statutory authority cited to you in connection with your appearance before this body today?

Mr. CAVANAUGH. 6(e), which I am aware of, Federal rule 6(e).

Mr. DINGELL. Federal rule 6(e)?

Mr. CAVANAUGH. Yes, sir, of the Federal Rules of Criminal Procedure.

Mr. DINGELL. And that is the only authority which was cited?

Mr. CAVANAUGH. That is the only citation I know of, sir.

Mr. DINGELL. I regret that I was out of the room at the time the initial questions were laid before you. The Chair is going to recognize other members for questions and may be compelled to deal with this issue from the standpoint of the responsibilities and the duties of the Chair as the questions go forward.

The Chair will recognize at this time Mr. Bilirakis.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

Agent Cavanaugh, have you ever been contacted by a member of the subcommittee staff concerning your investigation of Pratt & Whitney?

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. How many times and when were you contacted?

Mr. CAVANAUGH. Once personally. April 2, I believe it was, of this year, in West Palm Beach, FL.

Mr. BILIRAKIS. Once personally?

Mr. CAVANAUGH. Yes, sir. He came to our office in West Palm Beach.

Mr. BILIRAKIS. What does that mean? Were there contacts by telephone or with other members——

Mr. CAVANAUGH. Yes, he called me.

Mr. BILIRAKIS. He called you?

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. And that was in addition to that one time?

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. Have you ever met—well, you have already testified that you have met with a member of the subcommittee staff, right? And that took place in West Palm Beach.

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. And that was early in April?

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. Who initiated that contact?

Mr. CAVANAUGH. Mr. Stockton of your committee, I guess.

Mr. BILIRAKIS. You are not certain whether it was Mr. Stockton?

Mr. CAVANAUGH. Yes, sir, it was Mr. Stockton.

Mr. BILIRAKIS. How long did that conversation last and what was the substance of it? Can you recall?

Mr. CAVANAUGH. About an hour or a little over an hour in the afternoon in the FBI office. Seeking information pertaining to the investigation of Pratt & Whitney Government Products Division.

Mr. BILIRAKIS. Were you informed at that time, sir, that you would or could be called to testify before the subcommittee?

Mr. CAVANAUGH. Yes, sir, he did.

Mr. BILIRAKIS. And what was your response to him when he had advised you to that effect?

Mr. CAVANAUGH. That he would have to subpoena me.

Mr. BILIRAKIS. Was that your only response?

Mr. CAVANAUGH. In the spirit of cooperating, we have no problem. It is just that we cannot voluntarily give information out.

Mr. BILIRAKIS. Well, that's my point. Did you advise him of that, at that point in time?

Mr. CAVANAUGH. Yes, sir.

Mr. BILIRAKIS. All right. So you did understand that you would probably be subpoenaed to testify. Are you satisfied that he also understood that you would be limited in terms of your testimony?

Mr. CAVANAUGH. Yes, sir. It was explained. In fact, he was asked to contact our headquarters level to a particular office, the Congressional Affairs Office, because we could not speak to an issue without headquarters permission.

Mr. BILIRAKIS. And what were your reasons to him? In other words, basically, what did you say to him in terms of why you would be limited as far as your testimony was concerned?

Mr. CAVANAUGH. Federal rule 6(e), primarily.

Mr. BILIRAKIS. Well, we have Federal Rules of Procedure 6(e) here, but basically does it come down to the fact that a criminal investigation is underway and that your testimony might compromise that criminal investigation?

Mr. Cavanaugh. Yes, sir, we have an ongoing pending investigation, and therefore we are not allowed to disclose either the results or anything to do with that investigation. Further, the disclosure of any information obtained through the use of the Federal grand jury would be a violation of rule 6(e).

Mr. Bilirakis. And you made that clear to the committee's staff member?

Mr. Cavanaugh. Yes, sir.

Mr. Bilirakis. During the 1-hour discussion that you had with this gentleman in early April, did you discuss the substance of the investigation with him?

Mr. Cavanaugh. He already knew the substance, and we directed him to the assistant U.S. attorney who was handling the investigation. He happened to be in the building on that date, I believe, and we gave the phone number and room upstairs, and he and Mr. Spanton went upstairs.

Mr. Bilirakis. All right. But you didn't go into any of the details of your investigation?

Mr. Cavanaugh. We can't go into the details per se, sir.

Mr. Broyhill. Would the gentleman yield?

Mr. Bilirakis. I would be glad to yield.

Mr. Broyhill. I want to be fair about this. I wish I had the attention of the chairman.

Mr. Dingell. The gentleman from North Carolina always has my attention.

Mr. Broyhill. In the executive session of this committee when the subpoena was issued, this member, at least, was led to believe that this witness had information that he would give to the committee, and that the only thing we had to do was to issue a subpoena, and although it was not said, we were left with the understanding that there had been an investigation by the staff and there had been enough conversation with the staff and this witness that they knew what kind of information this witness would give.

Now, this witness now today tells us that from the beginning, he has stated what the FBI policy is with respect to disclosing anything in an active case, and certainly I brought up these points in the executive session, as the chairman will recall, and I am concerned that we may be approaching this whole case from the wrong direction.

Perhaps there are other witnesses where we can not only get this information, we can get the information that we need far easier than—without the possibility that we might be jeopardizing an ongoing investigation.

I just say that as my initial conclusion here, judging from what the witness has testified, the initial conversations he had with staff and the information that we were given at the executive session.

[The prepared statement of Mr. Broyhill follows:]

Statement of Hon. James T. Broyhill

It seems that almost every week we hear reports in the news that the Government is being billed excessive amounts for screwdrivers, hammers and nuts and bolts. This subcommittee has also undertaken an investigation of defense procurement practices which have uncovered instances where the Federal Government was billed for overhead charges which may not be allowable under Federal procurement practices. My colleagues and I have been active participants in the subcommittee inquiry which to date has saved the American taxpayers hundreds of millions of dollars.

However, there is an aspect about part of today's hearing which concerns me. We are scheduled to hear testimony from an FBI agent which the subcommittee subpoenaed last week. Since we issued our subpoena, I have received information that leads me to conclude that this witness's testimony may likely jeopardize an ongoing criminal investigation of an open case presently being conducted by the FBI and the U.S. Attorney's Office. For this reason, I will move at the appropriate time that we briefly adjourn the public hearing and convene an executive session. The purpose of this executive session would be to elicit sufficient information to determine the propriety of receiving the FBI's testimony in a public session. During the executive session, if we determine that the criminal prosecution would be compromised by the FBI agent's public testimony, then we should hear his testimony in that executive session. Upon the receipt of his testimony, we should then reconvene the public hearing to receive testimony from our other witnesses.

We all recognize that the subcommittee hearings have benefitted the taxpayer due to the sums recovered from the return of funds to the government for questionable billings. I do not wish to convene an executive session to thwart the subcommittee's attempt to examine the shortcomings of the procurement process. Rather, I want to ensure that defense contractors receive a strong message that Congress and the American people are not pleased with some of the questionable expenses that have been billed to the Government. The best way to deter the continuation of those questionable billing practices long after the publicity surrounding these hearings has died down is to ensure that a successful criminal prosecution is conducted by the Justice Department. The threat of serving a criminal sentence will send a message to the defense industry that they won't soon forget. Therefore, it is irresponsible for the subcommittee to proceed in an open session with this one witness if there is the slightest chance that we may jeopardize the success of an ongoing criminal investigation.

Mr. DINGELL. I detect that the gentleman from North Carolina is directing a statement at the Chair for purposes of——

Mr. BROYHILL. I do feel that perhaps we might excuse this witness and go on to the witnesses that can give us the information that we are looking for and that we can question with respect to what happened and when it happened and who did it.

Mr. DINGELL. The Chair proposes to address this matter in a most orderly fashion. The presence of Mr. Cavanaugh is, in the view of the Chair, essential to the proper development of the facts of the matter. The Chair intends to deal with matters and protections of 6(e), but to do so in accordance with the law and not in a fashion which permits Government agencies to distort, extend or overextend rules of the Court which may or may not be applicable in the terms that they would have them be applicable.

The Chair is delighted to have the gentleman's views. The Chair assures the gentleman that the Chair has no interest in jeopardizing an ongoing prosecution. The Chair simply observes that the questions which the Chair will direct at the gentleman—or rather at the witness, I believe can be answered without any impairment of the proceedings involving the possibility of a criminal prosecution which has been going on now for several years, hardly being conducted with extraordinary celerity, and so that we can begin to lay out the questions that I believe are relevant to what I see as a persistent pattern of incorrect bookkeeping, incorrect accounting, false charges, and perhaps failure to disclose necessary information which is important to the taxpayers.

I would observe that this subcommittee has always heeded with considerable respect questions relative to the——

Mr. BROYHILL. Mr. Chairman.

Mr. **Dingell** [continuing]. And will continue to do so. It is the view of the Chair that none of these questions will relate to testimony which is given before the grand jury.

Mr. **Broyhill.** Mr. Chairman, this member is considerably frustrated. There are some very serious allegations that have been made that have appeared in the public press about this particular case, and there is a need for this committee to get to the bottom of these questions and find out what has happened and when they happened and what our Government agencies have done and so forth; but we have called a witness when we knew full well at the beginning that this witness would not be forthcoming with this information.

It seems to me that those who have organized this hearing have purposely arranged for this roadblock to occur when we could easily call other witnesses and not have these roadblocks.

Mr. **Dingell.** The Chair is going to call the necessary witnesses in the appropriate order. I will be delighted to read the provisions of rule 6[e], just so we can understand——

Mr. **Broyhill.** I have already read it twice.

Mr. **Dingell.** Well, I want to read it because it has been raised on a number of occasions, and I just want the record to indicate what we are doing here is not in any way violative of the provisions of 6(e). It says:

> Secrecy of proceedings and disclosure: Disclosures of matters occurring before the grand jury other than its deliberations and the vote of any juror may be made to the attorneys for the government for use in the performance of their duties. Otherwise a juror, attorney, interpreter, stenographer, operator of a recording device, or any typist who transcribes recorded testimony may disclose matters occurring before the grand jury. Only when so directed by the court preliminary to or in connection with a judicial proceeding or when permitted by the court at the request of the defendant upon a showing that grounds may exist for a motion to dismiss the indictment because of matters occurring before the grand jury. No obligation of secrecy may be imposed upon any person except in accordance with this rule. The court may direct that an indictment shall be kept secret until the defendant is in custody or has given bail, and in that event the clerk shall seal the indictment, and no person shall disclose the finding of the indictment except when necessary for the issuance and execution of a warrant or summons.
>
> Finding and returning of indictment: An indictment may be found only upon the concurrence of 12 or more jurors.

And it goes on and so forth.

The Chair will remind all parties here present that the provisions do not deal with discussions by the witness, Mr. Cavanaugh, here this morning, of matters relative to actions taken by him except insofar as they relate directly to his appearances before the grand jury.

The law is well settled on this, and the Chair is not in any fashion uncomfortable with anything except that we are not receiving the cooperation as is necessary on instructions by the Department of Justice.

The Chair will inform the gentleman from North Carolina that the Chair has considerable experience as both a member of this body and as a trial attorney and as a member of the prosecutor's prosecutorial staff of a law enforcement agency, and the Chair will seek to carry out his responsibilities to this body not in a fashion which would reflect unfairly on the body nor in any fashion which would in any way impinge on the proper execution of either the rules of the Court, the laws of the United States or the rights of witnesses, but the Chair does intend to proceed carefully and slowly, and the Chair hopes that he will have the cooperation of all members in so doing.

The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Bryant.

Mr. Bryant. Thank you, Mr. Chairman.

Mr. Chairman, I would like to first ask of the staff counsel, Mr. Barrett, if it is correct that the understanding of the staff was that the witness who was coming forth today would be able to testify with a great deal more latitude than he has indicated this morning he would be able to testify to.

Mr. Dingell. Would the gentleman repeat the question? I think the Chair is going to have to respond to that.

Mr. Bryant. Well, I will direct it to the Chair. I just want to ask: Is it not the case that the staff was informed or was given the impression by the witness or people associated with the witness that he would be able to testify this morning with a great deal more latitude than he is now telling us he is able to testify.

Mr. Dingell. The answer to that question is yes. Perhaps in the interest of fairness to the members of the committee, the Chair should proceed to go through a number of questions here. The Chair apologizes to my colleagues because it has always been my intention to try and see to it that the time of the committee was fairly shared amongst the several members of the committee present in a fashion in accordance with the rules.

Now, the staff is going to present to you, Mr. Cavanaugh, papers on the direction of the Chair. The first is a photocopy of a check. It is headed with the words "Pratt & Whitney Aircraft Group." It says United Technologies, and is dated June 25, 1982, No. 98640. It also says in full settlement of items listed on accompanying statement. It is also marked vendor 98954, dated June 23, 1982.

It is in the amount of $67,500. What is this, please?

Mr. Cavanaugh. I'm sorry, sir. I cannot comment on this.

Mr. Dingell. It is to the Oklahoma Art Center.

Mr. Cavanaugh. I can see that, but I'm not allowed to comment on it and I'm not authorized pursuant to the rules and regulation's of the Department of Justice concerning the substance of our investigation.

Mr. Dingell. Now, that was a payment by United Technologies?

Mr. Cavanaugh. I have to stand on my previous answer, sir.

Mr. Dingell. All right.

I will have the staff submit to you now a letter directed to Major General J. T. Edwards, Commander, Oklahoma City Air Logistics Center, Tinker Air Force Base, Oklahoma. The letter reads as follows:

> Dear Jay. As we discussed, the Government Products Division of Pratt & Whitney will be pleased to help sponsor the Phillips Collection at Oklahoma City. We will fund 50 percent, or $67,000 of the exhibit and expect to send the Oklahoma Art Center a check soon.
>
> As you know, we are very interested in projects that promote the arts, and I think the Phillips Collection will be a marvelous addition to the area's already fine cultural environment. Pratt & Whitney feels very much a part of the Oklahoma City com-

munity and is glad to have the opportunity to make this contribution—Warm Regards, F.W. McAbee, Jr., President.

What is this document, please?

Mr. CAVANAUGH. It's a letter, as the Chairman just read, but I am not authorized to discuss it due to the ongoing investigation, sir.

Mr. DINGELL. I will present to you now or have the staff make available to you a document on Pratt & Whitney letterhead to Tom Aiton from Jim Nelson, Subject: Oklahoma Art Exhibit Funding, June 23, 1982: "Please draw up a check for $67,500 to cover Pratt & Whitney's contribution in support of the Phillips Collection exhibition at the Oklahoma Art Center. The check should be made out to Oklahoma Art Center." [See p. 23]

What is that document, please, sir?

Mr. CAVANAUGH. It is what the chairperson read. It is a memorandum, but I am not allowed to comment.

Mr. DINGELL. I'm not a chairperson. I'm a chairman, and when I become other than that, I am sure that many in this room will know. Some of them may even rejoice.

Mr. CAVANAUGH. No disrespect intended. I am just not allowed to comment on this, sir. I have not been authorized.

Mr. DINGELL. These represent an expenditure of $67,500. Was this charged to the Federal Government, this expenditure?

Mr. CAVANAUGH. I have not been authorized, sir. I cannot comment on that.

Mr. DINGELL. I will now have the staff present to you a photostat of a check, Pratt & Whitney Aircraft Group. It is made out to The Breakers, South County Road, Palm Beach, FL, in the amount of $33,268.31.

What is that document, sir?

Mr. CAVANAUGH. It appears to be a copy of a check, sir.

Mr. DINGELL. Now attached to that check is a document which is apparently a receipt from The Breakers, made out to Pratt & Whitney, Quarter, Ms. Gail Heiss, Post Office Box 2691, West Palm Beach, FL 33402. The total amount is $33,268.31, and one of the items is in the amount of $55 for, I believe, the bartender, and another item is "Banquet Function Wine" in the amount of $3,249.53. There is also another item for "Car Runners" in the amount of $270.

What are those documents, please, sir?

Mr. CAVANAUGH. They appear to be an itemized statement from The Breakers Hotel in Palm Beach.

Mr. DINGELL. Have you ever seen these documents before?

Mr. CAVANAUGH. I cannot comment on that, sir.

Mr. DINGELL. Were copies of these documents given to you by George Spanton?

Mr. CAVANAUGH. I can't comment on that, sir.

Mr. DINGELL. Will you describe the reason that you cannot comment on the documents that I have been showing you, please, sir?

Mr. CAVANAUGH. The ongoing criminal investigation, sir.

Mr. DINGELL. You have been instructed by your superiors that you are not to comment; is that right?

Mr. CAVANAUGH. That is correct, sir.

Mr. DINGELL. Who is it that instructed you so?

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Mr. CAVANAUGH. Assistant Director Oliver Revell.

Mr. DINGELL. On what grounds were you instructed that you were not to comment on these documents?

Mr. CAVANAUGH. I don't know the grounds, sir. We are operating under the rules and regulations of the Department of Justice, and without the authorization, we are not allowed to discuss this.

Mr. DINGELL. Can you tell us whether those items in the voucher and the check that I have just shown you were charged against the Federal Government by Pratt & Whitney?

Mr. CAVANAUGH. I cannot comment on that, sir. I have not been authorized to.

Mr. DINGELL. Do you know whether or not they were?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. You do? But you are not able to tell the committee?

Mr. CAVANAUGH. No, sir, I cannot comment.

Mr. DINGELL. Because you've been instructed not to cooperate with the committee?

Mr. CAVANAUGH. I have been instructed to cooperate within the limitations that they have given me, sir.

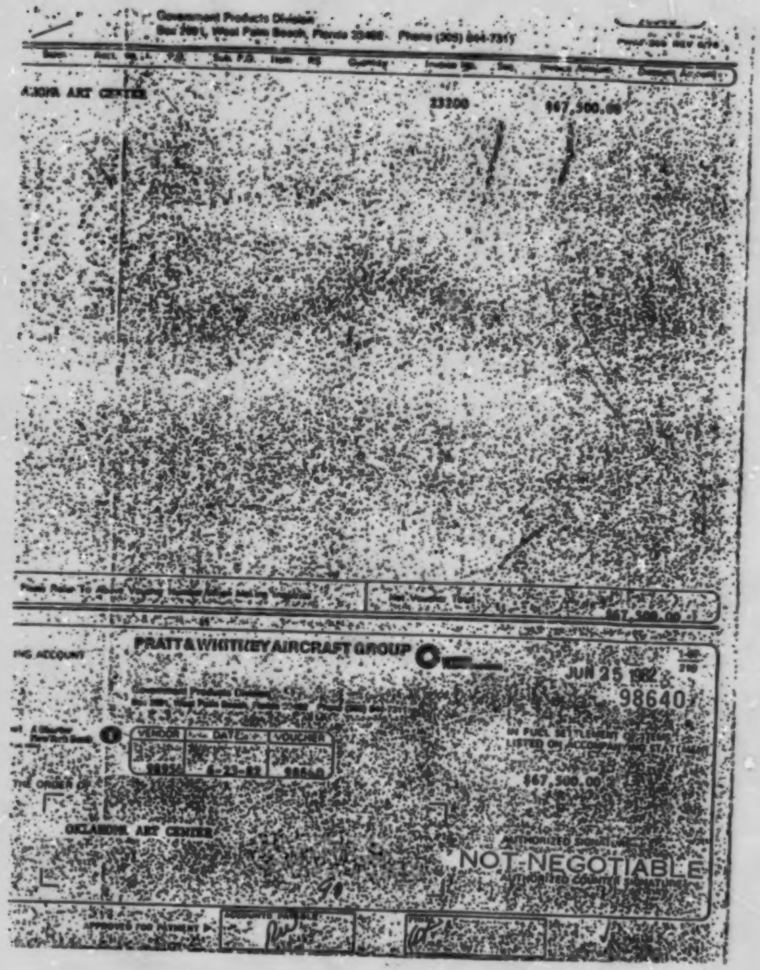
Mr. DINGELL. I find that to be a fine difference.

I will make available to you a copy of a document entitled "Voucher No. 97039, Pratt & Whitney Aircraft Group," payable to Gem Giftwares, Inc. It is Invoice No. 14150 in the amount of $10,220.68. And beneath that in the photostat is a photostat of a check in the amount of $10,220.68 made out to Gem Giftwares, and it is Vendor No. 96550, dated January 29, 1982, Voucher No. 97039.

Can you inform the committee what these documents are?

[The documents referred to follow:]

BEST COPY AVAILABLE



Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-7311

Date	Acct. No.	P.O.	Sub P.O.	Item	RS	Quantity	Invoice No.	Disc.	Invoice Amount	Discount Amount
AHOMA ART CENTER							23200		$67,500.00	

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $67,500.00

PRATT & WHITNEY AIRCRAFT GROUP

JUN 25 1982

98640

Government Products Division

VENDOR	DATE	VOUCHER
9895[illegible]	6-23-82	98640

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

$67,500.00

THE ORDER OF

OKLAHOMA ART CENTER

AUTHORIZED SIGNATURE

NOT NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT

Government Products Division
Frank W. McAbee, Jr.
President

16 April 1982

Major General J. T. Edwards
Commander
Oklahoma City Air Logistics Center
Tinker Air Force Base, OK 73145

Dear Jay:

As we discussed, the Government Products Division of Pratt & Whitney will be pleased to help sponsor the Phillips Collection at Oklahoma City. We will fund 50%, or $67,000, of the exhibit and expect to send the Oklahoma Art Center a check soon.

As you know, we are very much interested in projects that promote the arts, and I think the Phillips Collection will be a marvelous addition to the area's already fine cultural environment. Pratt & Whitney feels very much a part of the Oklahoma City community and is glad to have the opportunity to make this contribution.

Warm regards,

Frank

F. W. McAbee, Jr.
President

CC: Mr. Gordon Bowman
Mr. Donald L. Brown

Government Products Division

Internal Correspondence

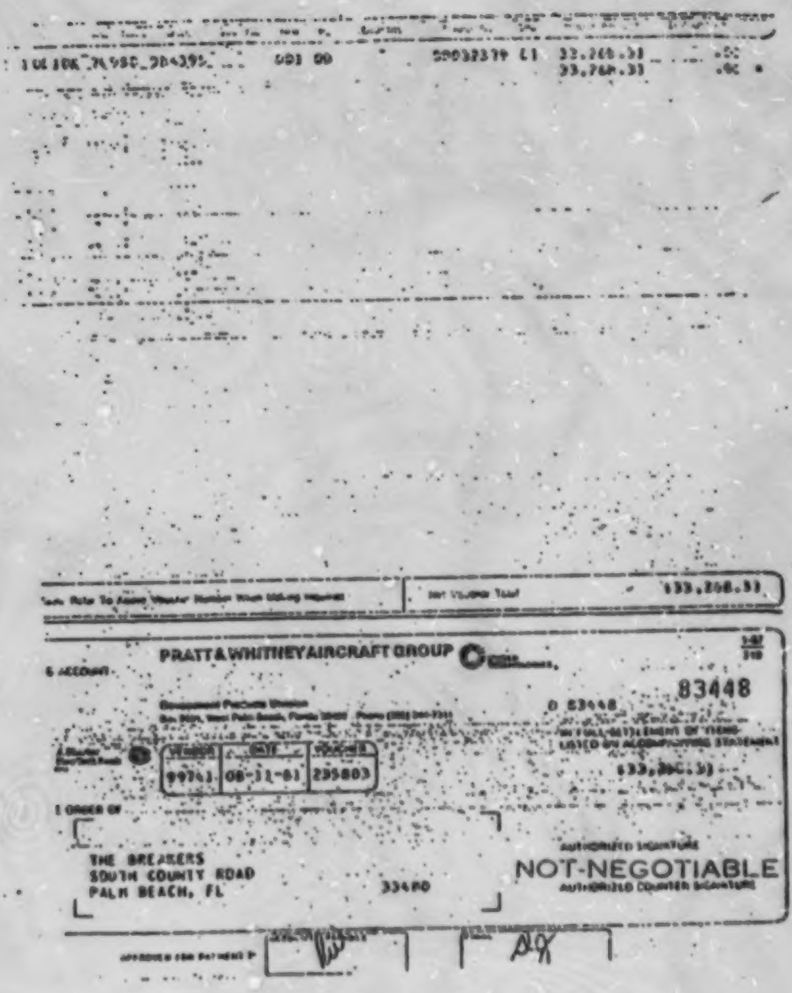
To: Tom Aiton
From: Jim Nelson
Subject: Oklahoma Art Exhibit Funding
Date: 23 June 1982

Please draw up a check for $67,500 to cover Pratt & Whitney's contribution in support of the Phillips Collection exhibition at the Oklahoma Art Center. The check should be made out to "Oklahoma Art Center."

Jim Nelson
Jim Nelson

Return ck. to CBF

acct 7498
Dept 100



10E10K 7L950 704395 001 00 00032379 L1 33,268.31 .00

33,268.31 .00

Please Refer To Above Voucher Number When Making Inquiries

NET VOUCHER TOTAL $33,268.31

PRATT & WHITNEY AIRCRAFT GROUP

83448

0 83448

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
99741	08-11-81	235803

$33,268.31

THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT

AQ

PRATT & WHITNEY QUARTER CEN CL
MS GAIL WEISS
P O BOX 2691
WEST PALM BEACH FL 33402

EP A
.00 .00 .00
CC6

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

Itemized Billing

6/27	501-040	DEP PRATT & WHITNEY	31006	1256.00	
6/29	307-003	ROOM SERV FOOD 06/27		248.16	Staff Party
6/29	311-014	BANQ FUNC FOOD 06/27		6685.64	[illegible]
6/29	311-017	BANQ FUNC FOOD 06/27		130.00	[illegible]
6/29	311-018	BANQ FUNC FOOD 06/27		476.01	Staff Luncheon
6/29	311-019	BANQ FUNC FOOD 06/27		17190.10	[illegible]
6/29	316-002	ROOM SERV BEV. 06/27		14.36	Staff Party
6/29	317-001	ROOM SERV WINE 06/27		83.72	Staff Party
6/29	318-001	ROOM SERV BOT. 06/27		214.92	Staff Party
6/29	325-005	BANQ FUNC WINE 06/27		3249.53	Wine w/Dinner
6/29	364-006	GRATUITIES		300.00	Gratuities
6/29	364-009	BARTENDER 06/27		55.00	Staff Party
6/29	364-010	CAR RUNNERS		270.00	Valet Parking
6/29	369-001	BEVERAGE RETURN		Bar Rebate - 132.66	
6/30	325-002	BANQ FUNC BEV. 06/27		5097.33	[illegible] Bar
7/07		SPOTLIGHT & OPERATOR 6/27		33.60	Spotlight & Operator

APPROVED

DEPT. 100, ACCT. 7498

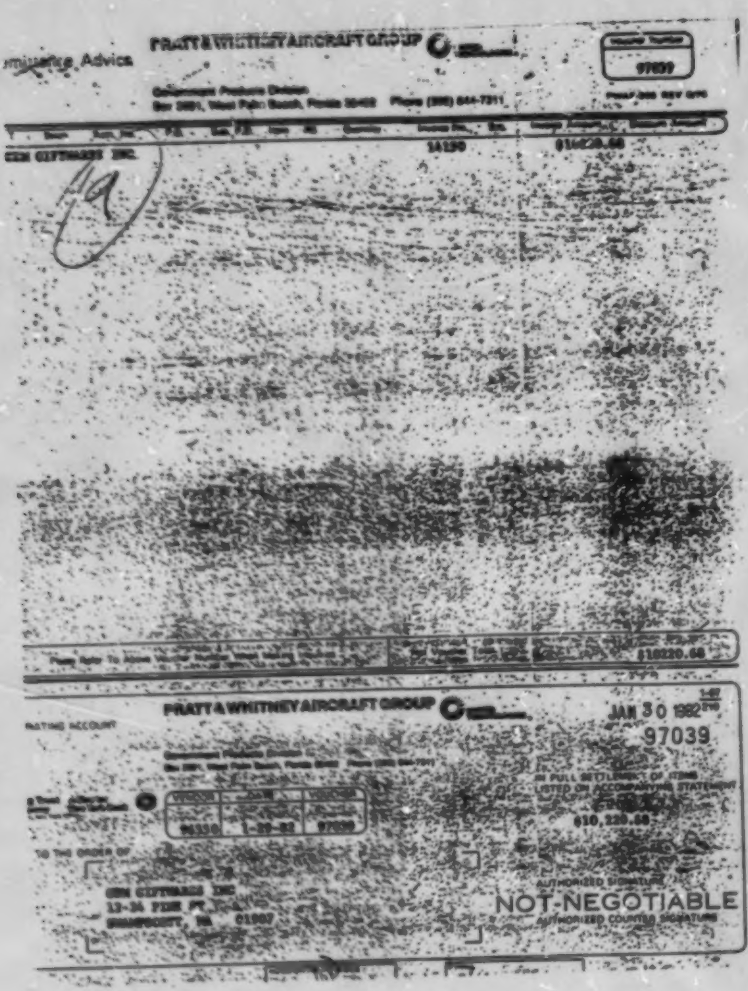
JUL 31

[illegible]

AMOUNT DUE 33,268.32

[illegible]

The Breakers



mittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-7311

Voucher Number
97039

CEN GIFTWARES INC. 14190 $10220.68

4a

Please Refer To Above Voucher Number When Making Inquiries $10220.68

PRATT & WHITNEY AIRCRAFT GROUP

JAN 30 1982

97039

PAYING ACCOUNT

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-7311

VENDOR	DATE	VOUCHER
96330	1-29-82	97039

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

$10,220.68

TO THE ORDER OF

CEN GIFTWARES INC
13-34 PINE ST
BRIDGEPORT, [illegible] 01907

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

BEST COPY AVAILABLE

GEM GIFTWARES, INC.

12-34 PINE STREET, SWAMPSCOTT, MASS. 01907
TEL. (617) 599-7780 • TOLL FREE (800) 225-2944 • TELEX 94-0437
GEMLIKE CREATIONS - ASI 5977

INVOICE

ORIGINAL COPY

SOLD TO:
PRATT & WHITNEY AIRCRAFT
ATT: A/P P.O BOX 2691
WEST PALM BEACH, FL.
ATT: PAMELA MORGAN
33402

SHIP TO:
SAME
ATT: ERNEST WRIGHT

THIS INVOICE NUMBER MUST APPEAR ON YOUR PAYMENT.

ACCOUNT NUMBER	ORDER DATE	CUSTOMER ORDER NUMBER	SALES-MAN	TERMS	SHIP VIA	INVOICE DATE	INVOICE NUMBER
1706	10/08/81	80399	9	NET 30	UPS	11/24/81	19150

ORDERED	QUANTITY SHIPPED	BAL.	PRODUCT NO.	COLOR	DESCRIPTION	UNIT PRICE	DISC. %	AMOUNT
300	300		9999	MISC	89301 ASST. OF PEN & PENCIL SETS W/PRATT & WHITNEY 8030917 EMBLEMS (PRICE INCLUDES EMBLEMS)	33.90		10,170.00
400	400		9999	MISC	EMBLEMS	.00		
						SUBTOTAL		10,170.00
						UPS CHG		50.60
						TOTAL		10,220.60

RECEIVED
NOV 18 1981
TREASURY DEPT.

THANK YOU FOR YOUR ORDER!

29

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87-411 O—85—5

INTER DEPARTMENT TRANSMITTAL

TRANSFERRED TO:

✓ DISCREPANCY SECTION: Liz

A. PRICE INVOICED -vs- P.O. PRICE

B. QTY INVOICED -vs- REC'D QTY

C. NAME VARIANCE

D. PROOF OF DELIVERY

E. NEED NET WT. ON RECEIVER

[✓ F.] MISC. Frt approval

Traffic 1-22-82

__ APPROVAL DESK ____

__ NON-P.O. DESK ____

__ COMPUTER RENTAL ____

INITIALS ____ 1-18-82 DATE

[illegible]

Date 1-22-82

Traffic P.A.

____ Buyer Code

Variance

oval Required

ument Required

Frt approval

rn To:

- Accounts Payable
  Mail Stop 60
  Attention: Lindy Robinett

BEST COPY AVAILABLE

Order

F 33339

Government Products Division
Box 2691 West Palm Beach, Florida 33402

J. P. McQuaid/jrs

0335

S-96590-A3-E-A

7699

10/22/81

November 15, 1981

Gem Giftwares, Inc.
6673 Moonlit Drive
Delray Beach, FL 33446
Attn: Ted Isaacson

300 94501 Cross pen/pencil sets with P&WA emblem (10K gold filled) 33.50/ea

Telephone order placed with Ted Isaacson on 10/22/81. Do not duplicate.

Do Not Overship

Total Commitment Value

9

RECORDED
DEC 31

3

SP

3 (Blue)

Deliver to United, FL SR/10 33402
Ernest B. Wright/A83

1 1 300 0

5344 24-95 RF C 11

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Mr. CAVANAUGH. I have not found that one. Could you give me a second, sir? I haven't found the one you're referring to in this assortment yet.

Mr. DINGELL. It is about three or four down from the top of the list of documents that you have been presented with.

[Pause.]

Mr. CAVANAUGH. It does not appear to be here, sir.

Mr. DINGELL. Would you see to it that copies are made available to the witness?

While the staff is gathering these documents to present to you, I would observe that I believe that it is in your interest to consult a personal attorney because of possible exposure to you under section 192, which requires cooperation by witnesses before a congressional committee, and I believe that your associate at the table should take back to his superiors and yours the possibility of prosecution of other officers of the agency under section 1505, title 18, United States Code, for obstructing the proceedings of the committee today.

Would you please tell us what—

Mr. BROYHILL. Mr. Chairman, would the gentleman yield at that point?

Mr. DINGELL. Of course.

Mr. BROYHILL. I think in all fairness, that it seems to me that we should be having witnesses here who could testify with respect to what these documents are. We can call Pratt & Whitney executives to testify as to what these documents are. And it seems to me that once again staff and perhaps the chairman knew in advance that this witness would not be able to testify, and yet knowing that, having knowledge of that, proceeded to schedule this hearing when we should have been spending our time questioning a witness who could testify with respect to these documents.

Now the gentleman, of course, has the responsibility of organizing the hearings, but it would seem to me that we should be proceeding to listen to the testimony of Mr. Spanton and listening to the testimony of Defense Contract Audit Group witnesses and listening to the testimony of Pratt & Whitney representatives as to what these documents are and how they were disposed of and how they were accounted for.

It seems to me, if we would be able to get that on the record and not have to go through this confrontation with a most respected organization, the FBI, and especially where they have an ongoing investigation and the concern that public testimony of what is going on there or in the grand jury might have the possibility of jeopardizing that criminal investigation. I don't think we want to do that.

And the gentleman told us in executive session that that was not his purpose.

Mr. DINGELL. Well, the Chair thanks the gentleman.

The Chair will observe for the benefit of the gentleman that it is not the purpose of the Chair that we should in any way impair the inquiry.

It is also not the intention of the Chair to spend fruitful time of the subcommittee in undertakings that bear no fruit. The Chair will inform the gentleman that the first that the Chair heard that

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the witness would not be able to testify fully was when the Chair appeared in the room this morning.

It had, prior to that time, been the full expectation of the Chair——

Mr. BROYHILL. Well, the witness just told us——

Mr. BRYANT. I would like a rule of order, so we could hear the Chair's explanation of what led up to this hearing today.

Mr. DINGELL. The Chair thanks the gentleman.

The Chair will observe and will repeat the observation made earlier that the first the Chair was aware that the witness would not be able to testify fully was this morning.

The Chair will observe that the record indicates that the instructions came to the witness at 9 o'clock this morning. The Chair will observe that the committee convened punctually at 10 o'clock or as near thereafter as the Chair could get clearance with regard to proceedings on the floor of the House.

The Chair is well aware of the constraints under which the witness appears, and the Chair is simply trying to see what the bounds of cooperation of the witness might be.

The Chair will observe for the benefit of the gentleman from North Carolina, for whom the Chair has the most intense and longstanding respect and affection, that the Chair is well aware that there are many ways that the committee can procure the information which it seeks, and the Chair does intend to procure the information by proper methods, giving due consideration to the respect that the Chair and, I'm sure, the gentleman from North Carolina have for Mr. Cavanaugh.

Mr. BROYHILL. Would the gentleman yield?

Mr. DINGELL. The Chair will be delighted to recognize the gentleman or yield to the gentleman in just a minute.

The Chair also wishes to inform the gentleman that the Chair is not unfamiliar with the provisions of section 6(e) or the other statutes which either confer or restrict the power of this committee, or rather confer authority on this committee or restrict its powers.

The Chair also is keenly aware of the fact that this committee and other committees have not infrequently proceeded into inquiries relative to matters in which they were engaged, in spite of the fact that there might have been some collateral proceeding, including criminal proceedings, elsewhere. And the Chair is also keenly aware that not only can this be done properly, if the matter is being conducted in an appropriate fashion elsewhere, without any impairment of the proceedings taking place in any other forum. That includes criminal prosecutions which might be taking place elsewhere.

Now the Chair is delighted to hear the gentleman if he has some further comments.

Mr. BROYHILL. Mr. Chairman, perhaps this is not the appropriate time, in any public forum like this, to advise the chairman that he is certainly a past master with respect to holding investigations. But it would seem to me that we would be spending our time more fruitfully and profitably if we were to be questioning witnesses who could respond and excuse this witness for now. And if we needed to bring him back, we could bring him back at a later time.

Mr. DINGELL. The gentleman's counsel is always appreciated by the Chair. And as the Chair has indicated, the gentleman from North Carolina is one of the oldest and most respected of the friends of the present occupant of the Chair, and the Chair has always listened with enormous respect to the comments that are made by the very wise and valuable Member from North Carolina.

The Chair is moving toward an appropriate conclusion of the matters before the committee today. The Chair will, of course, advise that it is most unlikely that the Chair will terminate in full the proceedings today when we adjourn, and that we will be soliciting the cooperation of other persons whom, I think, can afford us perhaps more complete cooperation in identifying the papers which the Chair has available for the assistance and information of the committee.

Let the Chair proceed——

Mr. BILIRAKIS. Mr. Chairman, may I be recognized for just a moment?

Mr. DINGELL. The Chair will yield to the gentleman.

Mr. BILIRAKIS. Well, sir, you know, I seem to be—and I suppose Mr. Broyhill—be put into a position here of defending the Federal Bureau of Investigation, and we shouldn't be in that kind of a position.

But I know we have a number of attorneys on this panel, and I don't know how in the world we can read the first sentence of this section 6(e) and still feel that this gentleman is breaking the law in terms of testifying before this group.

Disclosure of matters occurring before the grand jury, other than its deliberations and the vote of any juror, may be made to the attorneys for the Government for use in the performance of their duties. We certainly don't qualify in terms of being attorneys for the Government.

He is precluded from testifying. Now I thought this was going to be a hearing, sir, that would get us into the meat of the problems, and we're not getting anywhere.

Mr. BRYANT. Would the gentleman yield?

Mr. DINGELL. The Chair is going to observe that the Chair has been reading section 6(e) for a number of years and is well familiar with its contents.

The Chair also is going to observe that the Congress and this committee have had to address this question as the grand inquest of the land with power to follow any question upon which it might have interest in connection with legislation.

The committee is impanelled here to consider matters under its jurisdiction. The committee is not bound by the provisions of section 6(e), which might bind other persons in other places. But it does not bind this body.

Now the Chair is going to try and conduct this matter in an orderly fashion and hopes that he will have the cooperation of the members of the committee.

The Chair will observe that if the gentleman feels compelled during this hearing to defend the FBI, the Chair will be quite delighted to recognize the gentleman in the appropriate fashion and time for that purpose.

The Chair does not recall any attacks made on the FBI in connection with this matter at this time by the Chair or by any other person who is a member of the committee, and if the gentleman will recall, there was no such comment in the opening statements or any of the questions that were raised by the Chair.

Now, Mr. Cavanaugh, you have now had made available to you the documents referred to by the Chair?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. Could you tell us what they are, please?

Mr. CAVANAUGH. It appears to be a Xerox copy of a Pratt & Whitney check and an invoice for purchase of a particular item, sir.

Mr. DINGELL. Now those items, I believe, are a number of 10-carat Cross pen and pencil sets with Pratt & Whitney emblems, and there is also an interdepartmental transmittal sheet attached thereto?

Mr. CAVANAUGH. Yes, sir, there is.

Mr. DINGELL. What is that document, if you please?

Mr. CAVANAUGH. The interdepartmental transmittal, sir?

Mr. DINGELL. Yes, the interdepartmental transmittal.

Mr. CAVANAUGH. It is a Xerox copy of—like a memorandum, I would imagine, dated January 18, 1982.

Mr. DINGELL. And the last document attached to this, under the logo of Pratt & Whitney, is the logo of Government Products Division, Pratt & Whitney, and it is a purchase order, Cross pen and pencil sets with P&W emblem, 10-carat gold filled.

Have you seen this document before?

Mr. CAVANAUGH. I would not be able to comment on that, sir.

Mr. DINGELL. What is this document?

Mr. CAVANAUGH. It is a Xerox copy of a Pratt & Whitney purchase order, it appears.

Mr. DINGELL. Do you know whether this was charged to the Federal Government or not?

Mr. CAVANAUGH. I cannot comment on that, sir.

Mr. DINGELL. Very well.

The Chair is going to make an announcement. The Chair is distressed that we have been advised so late, relative to your cooperation, Mr. Cavanaugh.

The Chair recognizes that you do have certain problems in connection with your appearance today. The Chair is going to try and be understanding of those problems. The Chair, however, is going to make it very clear that we are going to get some answers on these matters in an appropriate fashion and time and from appropriate witnesses.

We hope that, on recess of the committee, that it will be possible for the committee to achieve perhaps a greater cooperation from you, Mr. Cavanaugh, and from your superiors in connection with this matter.

The Chair will observe that when we excuse you today, Mr. Cavanaugh, you will continue to consider yourself subject to the compulsory process which has produced you here this morning. I'm sure you understand what that means.

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. And that upon the call of the committee, at the appropriate time and place, you will return to discuss such questions as the committee might choose to discuss with you.

It is also the hope of the committee that at that time you will be more cooperative. It may be that the committee will choose, in some appropriate fashion and time, to discuss matters relative to this with your superiors, who appear to have some knowledge of matters superior to yours, and it may be that it will be the choice of the committee to test that superiority of knowledge and information.

Mr. BROYHILL. Would the gentleman yield?

Mr. WYDEN. Would the gentleman yield?

Mr. DINGELL. The gentleman will yield first to the gentleman from North Carolina and then the Chair will yield to the gentleman from Oregon and other members of the committee in appropriate order.

Mr. BROYHILL. I and the other minority members want to be helpful to the chairman in fully developing the facts in this case, and the only concern I have is that the witness testified several minutes ago that the staff had knowledge prior to his coming here or appearing there today that he would be limited in the testimony that he could give to the committee, and for the reasons that he has articulated.

Mr. DINGELL. If the gentleman will permit, staff was informed at earlier times that he would cooperate in full with the committee within the limits or rule 6(e). If the gentleman will recall, the Chair advised that it would be the intent of the committee to respect the limits of rule 6(e), even though the Chair believes that this rule is not binding upon the committee. And the Chair will inform the gentleman that the provisions of rule 6(e), in the interpretation of the Chair and in the interpretation of responsible legal scholars, do not preclude the testimony of the witness today.

Regrettably, the witness is under constraints from his superiors which preclude his full cooperation, I believe, either upon a knowing, or perhaps less-informed, judgment of the requirements of section 6(e).

So the Chair is keenly sensitive to the gentleman's concern. It is the intention of the Chair to cooperate with members of the committee in perceiving a course and in carrying forward a course which provides the necessary information with regard to the questions which the Chair and the committee have today.

Mr. BROYHILL. The only point I am making is that there seems to have been some prior knowledge by some—I'm not saying it's the chairman, but at least perhaps the staff—according to the testimony of the witness, that we would not be getting answers to our questions.

It seems to me that what we should have done in organizing these hearings today is to have had witnesses that could have answered these questions. And it seems to me that we should proceed with calling those witnesses and proceed with asking them pertinent questions with respect to these documents, and find out what did happen and whether or not they were charged to the Government.

These kinds of questions need to be answered.

Mr. DINGELL. The Chair commends the gentleman, and the Chair agrees.

The Chair will inform the gentleman that yesterday, late in the day, I believe at 4 o'clock, the Chair and members of the staff of the subcommittee met with Mr. Steve Trout of the Department of Justice who was the highest official available at the Department of Justice at that particular time to talk to me. He is the Assistant Attorney General in charge of the Criminal Division, and he is in charge of, I would infer from his position and from my knowledge of that position, of criminal cases.

He did not indicate to us at that time that the witness would be instructed not to testify. And so I believe that the record will indicate that if information became available to the committee or the staff, it became available after 9 o'clock this morning.

The Chair will advise that the Chair was not aware of any refusal by the Department to proceed. The Chair is not aware of any prohibitions under the language of rule 6(e) that the witness should not testify on the matters.

The Chair will advise that the Chair has considerable concern and compassion for a government employee who is placed in the difficult position of serving the interest of justice or serving the instructions of his masters, and the Chair will seek to provide the necessary guidance in appropriate places, not to in any way denigrate the responsibility or the dignity of a valued and respected Federal employee such as Mr. Cavanaugh.

And the Chair accepts the counsel of the gentleman that there are other ways of getting the information, and the Chair will assure that we will get the information in other fashions, or we will get it by dealing with the Department of Justice, if that, in fact, is necessary.

The Chair recognizes the gentleman from Oregon.

Mr. WYDEN. Just very briefly, Mr. Chairman, because I think you have handled this matter with great care, but it seems to me that the Justice Department is restricting the subcommittee access to information in a fashion that goes beyond the rule 6(e) requirement. And I think that this subcommittee needs to know what is the motive behind such a restriction.

We are trying to get at a national scandal, a full-blown national scandal, and they are restricting this subcommittee's investigation in a fashion that goes beyond the law.

And I appreciate the Chair's care with which he is conducting this. But I hope that we will look into this and find out what the motivation is for going to restrict information to this degree, well beyond what the law requires. And I thank the Chair for yielding.

Mr. SHELBY. I wonder if the gentleman would yield?

Mr. DINGELL. The Chair is going to recognize my other colleagues.

The gentleman from Alabama.

Mr. SHELBY. Mr. Chairman, I just want to know if you would yield just for an observation.

Without going into everything here today, I, too, recognize the dilemma that the witness is in here today, but as an ongoing investigation by this subcommittee of various defense contracting problems—and we have pointed them out here on this very committee through witnesses before, and we want to continue to do this to unravel one of the real problems in the defense contracting, the overcharging and everything—I was sitting here wondering if there is any reason why the Justice Department would be afraid of your testimony?

In other words, they certainly are not cooperating at this time with the Oversight and Investigations Subcommittee, headed by the chairman, our distinguished chairman from Michigan. They are very aware of what we have been doing in this subcommittee for the past several months of the problems. And it looks like they would be interested—"they" being the Justice Department—in what we are, seeing that the taxpayer is protected, seeing that a dollar spent for defense is a real dollar.

And I know that you have been involved in the investigation, and I look forward to hopefully sometime hearing your testimony. I know you are under certain constraints, as others are, and we respect you for that. But I have to believe that the Justice Department could do more. They could cooperate better than they are doing at this point.

You know, I feel, sitting up here as a member of this committee, we shouldn't be struggling with the Justice Department. They should be opening up to us, because they should be after what we are after. I hope that they are. I trust that they are. But at times, I have my doubts.

Thank you, Mr. Chairman.

Mr. DINGELL. The gentleman from Texas.

Mr. BRYANT. Mr. Chairman, I would just like to make it clear, I think Mr. Broyhill's comments may have left perhaps an inaccurate impression of what is going on here today.

The statement that has been given to this committee by Mr. Cavanaugh says that he is not testifying today because he has not been authorized to testify concerning the substance of the investigation, "nor am I authorized to respond to questions concerning FBI policy." That has nothing to do with rule 6(e) or any other rule. That is simply a restatement of the directive given to him by his superiors not to testify to this committee. It has nothing to do with the law.

His statement goes on to say that, in addition, he would not be able to respond to anything that impinged on the section 6(e) rule. So I think we understand as a committee, and that those who listen to the hearing or watch the hearing or read of it, recognize that what Mr. Cavanaugh is saying is that his superiors will not allow him to testify today, not that there's any legal reason why he can't testify.

Mr. DINGELL. The Chair thanks the gentleman.

Are there further questions or comments of members?

I'm sorry. If the gentleman has questions, the Chair will recognize the gentleman.

Mr. BRYANT. I'm sorry. I thought you were just recognizing us to discuss the matter.

Mr. DINGELL. If that be the case, the Chair will recognize the gentleman from Minnesota for comment or questions.

Mr. SIKORSKI. I think the gentleman from Texas——

Mr. **Dingell**. Very well. The Chair will recognize, then, the gentleman from Texas for questions.

Mr. **Bryant**. Mr. Cavanaugh, the FBI is an investigative agency of the U.S. Government that investigates violations of Federal criminal law; is that correct?

Mr. **Cavanaugh**. That is correct, sir.

Mr. **Bryant**. When cases are brought to your attention or you are in some fashion directed to undertake an investigation, I assume you carry those investigations out and then refer them for prosecution to the U.S. attorney; is that correct?

Mr. **Cavanaugh**. That is correct, sir.

Mr. **Bryant**. Have you referred or suggested prosecution of Pratt & Whitney to the U.S. attorney?

Mr. **Cavanaugh**. Yes, sir. They are fully aware of the results of our investigation.

Mr. **Bryant**. OK. Now prior to coming here today, did you have any discussions with the U.S. attorney in Florida about your appearance before this subcommittee?

Mr. **Cavanaugh**. No, sir.

Mr. **Bryant**. Did you have any discussions with any of the assistant U.S. attorneys in the area—that is, in the office where you referred the Pratt & Whitney case—with regard to your appearance here today?

Mr. **Cavanaugh**. I notified the assistant U.S. attorney upon receipt of the subpoena.

Mr. **Bryant**. And did you have any discussions with him about your testimony here?

Mr. **Cavanaugh**. No, sir.

Mr. **Bryant**. All right. Who is the first representative of the Justice Department you discussed your appearance here with?

Mr. **Cavanaugh**. I do not know, sir. I'm not being evasive. I don't know the name of the gentleman.

Mr. **Bryant**. So the highest ranking person——

Mr. **Cavanaugh**. I have not discussed it with anybody except—I don't know the gentleman's name that I met here, and that is the only person I have talked to.

Mr. **Bryant**. Whom you have met here? What do you mean here? Here in the room?

Mr. **Cavanaugh**. I don't know the man's name who was from the Department of Justice. I personally have not talked to anybody other than one man here, who introduced himself, and that's it.

Mr. **Bryant**. You personally only talked to one person who introduced himself to you in this room?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Bryant**. And what was his name?

Mr. **Cavanaugh**. I did not catch it, sir.

Mr. **Bryant**. Well, would you look around and see if you see him sitting here in the room?

Mr. **Cavanaugh**. Michael Dolan, they tell me.

Mr. **Bryant**. Dolan? And he works for the Justice Department?

Mr. **Cavanaugh**. That's my understanding.

Mr. **Bryant**. All right. Now why did he come here to meet you today?

Mr. **Cavanaugh**. I don't know that he did, sir.

Mr. **Bryant**. Well, why did he introduce himself to you today?

Mr. **Cavanaugh**. I don't know, sir.

Mr. **Bryant**. Well, did you have a discussion with regard to this appearance?

Mr. **Cavanaugh**. No, sir.

Mr. **Bryant**. Well, how do you know who he worked for?

Mr. **Cavanaugh**. He introduced himself here and tried to explain how you sit up there. I have never seen this before.

Mr. **Bryant**. And that's all that he did?

Mr. **Cavanaugh**. Yes, sir, to be truthful.

Mr. **Bryant**. Well, who was the highest ranking member of the Justice Department that you had a conversation with about this case, about this appearance?

Mr. **Cavanaugh**. I have not personally talked to anybody in the Department of Justice about this, sir.

Mr. **Bryant**. Well, who delivered the instruction to you not to testify?

Mr. **Cavanaugh**. It was not instructions not to testify, but to testify within the limitations set forth in my opening statement.

Mr. **Bryant**. Who told you to testify or to limit your testimony to what you said in your opening statement?

Mr. **Cavanaugh**. The Assistant Director, Oliver Revell, in charge of the Criminal Division.

Mr. **Bryant**. Assistant Director of the FBI, and you had a conversation with him on the phone?

Mr. **Cavanaugh**. No, sir. In person.

Mr. **Bryant**. What did he tell you?

Mr. **Cavanaugh**. Just that.

Mr. **Bryant**. Well, what else did he tell you?

Mr. **Cavanaugh**. To tell the truth.

Mr. **Bryant**. The chairman wants to know who was present, and describe, would you, the discussion you had with him precisely.

Mr. **Cavanaugh**. I cannot tell who all was present, and I do not feel that it is appropriate to respond concerning policy questions of the FBI, sir.

Mr. **Bryant**. Well, I'm not interested in what you feel is appropriate. I'm asking a question. If you say you're not going to answer, just say you're not going to answer. But there is no question of propriety, because propriety is not a decision for you to make.

Mr. **Cavanaugh**. I respectfully decline to answer, sir.

Mr. **Bryant**. You will not tell us who was present in the room at the time?

Mr. **Cavanaugh**. I can tell you some of the names, but I do not recall all the names.

Mr. **Dingell**. Who, to the best of your knowledge, was present when the discussion took place?

Mr. **Cavanaugh**. Assistant Director Oliver Revell.

Mr. **Dingell**. And who else?

Mr. **Cavanaugh**. I don't know who else, sir. There were other individuals coming and going. I can't give you a list of names.

Mr. **Dingell**. Who were those other individuals, if you know them? Do you know the names of any of the persons who were coming and going?

[Pause.]

Who else was present in the room at the time that this discussion took place?

Mr. **Cavanaugh.** There were any number of people, sir. Emil was there with me; the agent sitting next to me from headquarters.

Mr. **Dingell.** All right. And who else, if you please?

Mr. **Cavanaugh.** The agent right over here, Tom Reynolds, and Jim Roth.

Mr. **Dingell.** And who else?

Mr. **Cavanaugh.** I don't know—oh, Helterhoff was one.

Mr. **Dingell.** Were you invited to the meeting?

Mr. **Cavanaugh.** I was invited to the meeting, sir.

Mr. **Dingell.** Now what did the other participants that you have identified to us have to say in the course of that meeting? Did they say anything?

Mr. **Cavanaugh.** No, sir, other than that we are trying to cooperate with you under the constraints that we have to operate under with the Department of Justice's regulations.

Mr. **Dingell.** What did they say about cooperating with the committee under the constraints?

Mr. **Cavanaugh.** That rule 6(e) prohibits me from discussing any of the matters within the grand jury's purview, and that Department of Justice regulations prohibit me from talking about an ongoing investigation.

Mr. **Dingell.** I am well aware of that. But let me repeat the question.

What did each of these other gentlemen have to say at this meeting?

Mr. **Cavanaugh.** Basically that. That was it.

Mr. **Dingell.** Not basically that. Do you remember the meeting?

Mr. **Cavanaugh.** Yes, sir.

Mr. **Dingell.** What did the gentleman sitting immediately to your right have to say?

Mr. **Cavanaugh.** That we had to operate under these constraints, that limitations are placed on it.

Mr. **Dingell.** Was that an observation or an instruction?

Mr. **Cavanaugh.** That was an observation from him.

Mr. **Dingell.** What did the other gentleman say?

Mr. **Cavanaugh.** The same observations.

Mr. **Dingell.** Is that all they said?

Mr. **Cavanaugh.** Yes, sir.

Mr. **Dingell.** That's all?

Mr. **Cavanaugh.** We tried to contact the Department of Justice to get the authorization.

Mr. **Dingell.** They had tried to contact the Department of Justice to get the authorization? What authorization?

Mr. **Cavanaugh.** The parameters have to be set forth in the Department of Justice, is my understanding of it.

Mr. **Dingell.** The parameters have to be set forth by the Department of Justice? What parameters?

Mr. **Cavanaugh.** That I can respond to with these limitations, sir.

Mr. **Dingell.** What are those parameters?

Mr. **Cavanaugh**. That I have set forth in the opening statement are basically them. That's it. And without the appropriate authorizations, I cannot do so.

Mr. **Dingell**. Did they explain to you exactly what the parameters were and what you could say to the committee?

Mr. **Cavanaugh**. Within the parameters set forth within my opening statement, yes, sir.

Mr. **Dingell**. Who prepared that opening statement for you?

Mr. **Cavanaugh**. I would say Jim Roth here from the congressional affairs office.

Mr. **Dingell**. He handed you that statement?

Mr. **Cavanaugh**. Yes, sir. It was typed up and then handed to me.

Mr. **Dingell**. And what were your instructions with regard to that statement?

Mr. **Cavanaugh**. That if asked, I could read this to the chairman and to the committee upon appropriate introduction.

Mr. **Dingell**. What else were you told that you were to testify to? Were you told to tell how you were within the parameters of 6(e), or was there any discussion of what 6(e) said?

Mr. **Cavanaugh**. No, sir.

Mr. **Dingell**. You were told to stay within 6(e), but you weren't told what 6(e) says?

Mr. **Cavanaugh**. I know what 6(e) is, sir, to my understanding of 6(e). I am not a lawyer. But I understand what I interpret to be 6(e).

Mr. **Dingell**. Have you read 6(e)?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Wyden**. Would the chairman yield for a question?

Mr. **Dingell**. Oh, I apologize. I've been intruding on the time of the gentleman from Texas.

Mr. **Bryant**. In your meetings with Assistant Director Revell, which, by the way, took place at what time?

Mr. **Cavanaugh**. Approximately 9 o'clock this morning, sir.

Mr. **Bryant**. And that's when you were first told what the parameters of your limitations—that is, what the limitations on your testimony would be; is that correct?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Bryant**. How long was that meeting?

Mr. **Cavanaugh**. Ten minutes. That's an estimate on my part.

Mr. **Bryant**. Ten minutes?

Mr. **Cavanaugh**. Yes, sir.

Mr. **Bryant**. Well, that doesn't sound like enough time for people to be coming and going, as you described earlier.

Mr. **Cavanaugh**. It was.

Mr. **Bryant**. Well, why were they coming and going?

Mr. **Cavanaugh**. I think we are getting into an area of FBI policy, sir, and I have to respectfully decline.

Mr. **Bryant**. FBI policy is not a secret to anybody. Why would you not talk to us about FBI policy?

Mr. **Cavanaugh**. I'm not authorized to do so.

Mr. **Dingell**. Would you inform us under what authority you refuse to discuss FBI policy with the committee? Cite the specific statutory for such refusal?

Mr. CAVANAUGH. The rules and regulations, Department of Justice, that I operate under.

Mr. DINGELL. OK. Any constitutional right?

Mr. CAVANAUGH. I am not qualified to say, sir.

Mr. DINGELL. Very well.

The gentleman from Texas.

Mr. BRYANT. What does FBI policy have to do with people coming and going from a meeting?

Mr. CAVANAUGH. What is the question, sir? I don't understand.

Mr. BRYANT. Well, how is it that in a ten-minute meeting, people could be coming and going, so many that you couldn't even count the number in the room, as you testified earlier? And you said in response to that, that it had something to do with FBI policy. I don't understand the connection.

Mr. CAVANAUGH. Sir, I have been assigned to south Florida for the last 12 years. I am not familiar with the people on board at the headquarters level. And quite frankly, I did not know the names of those individuals.

Mr. DINGELL. If the gentleman would permit, what FBI policies specifically do you cite, which precludes your response to the question raised by the gentleman?

Mr. CAVANAUGH. I only cite the rules and regulations, Department of Justice, and I am operating under instructions imposed upon me by the Assistant Director.

Mr. DINGELL. For the assistance of the committee, please inform us which one of the rules that you cite.

Mr. CAVANAUGH. I will have to submit it in writing later, sir, to do it for the record, because I do not know.

Mr. DINGELL. I am curious how you cite a rule that you do not know. Are you citing the instructions that you have received from your superiors, or are you citing the rules and policies of the Department of Justice?

Mr. CAVANAUGH. I'm citing the rules I received from my superiors.

Mr. DINGELL. The rules or the instructions?

Mr. CAVANAUGH. The instructions I was given, sir.

Mr. DINGELL. That is different than FBI policy, is it not?

Mr. CAVANAUGH. Not to me, sir. That's policy.

Mr. DINGELL. The gentleman from Texas.

Mr. BRYANT. Mr. Cavanaugh, the investigation of Pratt & Whitney began in July 1982 and was completed in December 1984; is that correct?

Mr. CAVANAUGH. No, sir. October 1982, completed in the summer of 1984.

Mr. BRYANT. OK. Now the FBI sent a letter to the U.S. attorney in January 1985 saying that, if you don't prosecute on this case, we're going to close the file; is that correct?

Mr. CAVANAUGH. That is correct, sir.

Mr. BRYANT. How can you answer the questions I just asked you and not answer the questions that have been asked previous to this?

Mr. CAVANAUGH. That is within the limitations that I have been instructed, that I could answer that, sir.

Mr. BRYANT. Well, it sounds as though the rules you have been instructed to follow in testifying here are more extensive than we previously thought.

Would you just explain to us what those rules are? How is it that those questions I just asked fit into the rules, and the other ones we have asked don't?

Mr. CAVANAUGH. I'm not qualified to answer that, sir.

Mr. BRYANT. Well, just tell us, what are the rules that you are required to follow this morning?

Mr. CAVANAUGH. That particular item does not impact on the investigation itself. It's a fact that the letter was written and a fact that the letter was given to the U.S. attorney.

Mr. BRYANT. What else can you testify to?

Mr. CAVANAUGH. That after the letter was written, that we had consultations with the assistant U.S. attorney, and that the matter is in a pending status, awaiting a prosecutive opinion from the assistant U.S. attorney.

Mr. BRYANT. OK. Has the 45 days elapsed between which you were to submit the letter—that is, between which you submitted the letter and "we are going to close the file"?

They have elapsed? Have you closed the file?

Mr. CAVANAUGH. No, sir. Prior to that time, we had consultations with the U.S. attorney's office, and it was the decision to leave it in a pending status because we are going to go forward and get a prosecutive opinion.

Mr. DINGELL. Say that again. You said "leave it in a pending status?"

Mr. CAVANAUGH. Yes, sir. There is a pending investigation.

Mr. DINGELL. What does that mean?

Mr. CAVANAUGH. It is a pending investigation.

Mr. DINGELL. All right. You were going to leave it in a pending status. Pending what?

Mr. CAVANAUGH. It's a status we use administratively in the FBI when an investigation is ongoing.

Mr. DINGELL. All right. Now, you had some other comment. You said you were going to leave it in a pending status and what else was going to happen?

Mr. CAVANAUGH. Awaiting the prosecutive opinion of the assistant U.S. attorney.

Mr. DINGELL. Awaiting the prosecutive opinion?

Mr. CAVANAUGH. Yes. Or a request for an additional investigation.

Mr. DINGELL. What does that mean?

Mr. CAVANAUGH. If there were any other parameters or any other items that they deem necessary to the investigation, they could so request it, and we, as the FBI, would conduct the investigation.

Mr. DINGELL. Were you subsequently requested to conduct additional investigative actions?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. You were not? That is from the time of the letter until this date?

Mr. **Cavanaugh.** From the time of the letter, minus the time we had the consultation with the U.S. attorney and the assistants, which would be mid-January 1985.

Mr. **Dingell.** So nothing has occurred since that January date?

Mr. **Cavanaugh.** No, sir.

Mr. **Dingell.** What has occurred since the summer of 1984? Has any action been taken since December 1984?

Mr. **Cavanaugh.** I don't feel that falls within the purview. I am going to have to respectfully decline.

Mr. **Dingell.** Well, I'm curious. You told us that nothing has occurred since the January letter. Then I asked, had anything occurred since the summer of 1984.

Has anything occurred in the way of investigative action by the Department of Justice?

Mr. **Cavanaugh.** We had completed our investigation, essentially, in the summer of 1984. It was referred to the assistant U.S. attorney or the U.S. attorney's office.

Mr. **Dingell.** Had the U.S. attorney asked you for additional investigative action by the FBI subsequent to the conclusion of that investigation?

The gentleman from Texas.

Mr. **Bryant.** I don't have any further questions, Mr. Chairman.

Mr. **Dingell.** The gentleman from Minnesota.

Mr. **Sikorski.** I thank the chairman.

Mr. Cavanaugh, you said earlier, after your meeting where the people were coming and going, that one of the gentlemen here with you mentioned that a request had been made of Justice to waive the restrictions with regard to your testimony today. Did I hear you correctly?

Mr. **Cavanaugh.** I don't think I used the term waive. If I did, I don't know. But they were in discussion with somebody at the Department of Justice.

Mr. **Sikorski.** To lift?

Mr. **Cavanaugh.** Or to decide the parameters of what I would be allowed to testify to.

Mr. **Sikorski.** Who was the agent in that room that told you that?

Mr. **Cavanaugh.** I don't know the name of the specific agent. These agents here may have talked to him. I don't know. I have not personally talked to anybody over at the Department of Justice.

Mr. **Sikorski.** I understand. But you said just a few minutes ago that one of the agents here, in that meeting where you were given your instructions as to what to do here today, raised the issue that contact had been made with Justice on the parameters of your testimony.

Mr. **Cavanaugh.** Contact had been made with Justice, I assume, sir, from conversations I have heard. I do not know that. I have not spoken with anybody at Justice.

Mr. **Sikorski.** No, I understand that. But did you not say a few minutes ago that in your discussions in getting your marching orders today, that you had to obey the policy and 6(e) and that that order had been given through Justice, even though discussions had

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taken place with Justice to loosen those restrictions and allow you freely to testify?

Mr. CAVANAUGH. Within the parameters I have set forth in my opening statement, I have not been authorized——

Mr. SIKORSKI. I understand all that. Please just answer my question. You're in the business of asking questions day in and day out.

Mr. CAVANAUGH. I don't know what your question is.

Mr. SIKORSKI. The question is, who at Justice was contacted?

Mr. CAVANAUGH. I have no idea.

Mr. SIKORSKI. Who in the FBI was dealing with Justice on the issue of your testimony?

Mr. CAVANAUGH. I would say Oliver Revell, the Assistant Director, not because I was party to the conversation, but you know——

Mr. SIKORSKI. But because he had conversations with them?

Mr. CAVANAUGH. I assume that. I don't know that. I would assume he did.

Mr. SIKORSKI. Did he imply that he had conversations with them?

Mr. CAVANAUGH. Not to me.

Mr. SIKORSKI. Do you know of any one of the agents, anyone in the FBI, who was contacting Justice on your testimony?

Mr. CAVANAUGH. I could not give you the name of an agent.

Mr. SIKORSKI. But someone did?

Mr. CAVANAUGH. I believe so.

Mr SIKORSKI. You were given the distinct impression that Justice had not waived any restrictions on testimony, and the restrictions that were told to you were that you couldn't testify as to 6(e) or anything involving the substantive nature of the investigation or on FBI policy; is that correct?

Mr. CAVANAUGH. That is correct.

Mr. SIKORSKI. That came out of Justice?

Mr. CAVANAUGH. It came to me through the Assistant Director, but I believe it came out of Justice indirectly.

Mr. DINGELL. Would the gentleman yield?

Mr. SIKORSKI. Certainly.

Mr. DINGELL. You indicated in your opening statement and in a response to Mr. Sikorski's followup, you have not been authorized to testify concerning the substance of the investigation, nor are you authorized to respond to questions concerning FBI policy.

You also observed that you have no authority to release FBI documents.

You further stated that you were bound by the terms of rule 6(e) and its language, and you said further that rule 6(e) of the Federal Rules of Criminal Procedure prohibits you from testifying concerning matters occurring before the grand jury.

Were those your instructions in so many words?

Mr. CAVANAUGH. In so many words, yes, sir.

Mr. DINGELL. Were you instructed that you were not to identify documents?

Mr. CAVANAUGH. Not specifically; no, sir.

Mr. DINGELL. Now you are bound by the provisions of 6(e). You have defined 6(e) to say as follows, that it, quote, prohibits me—and that is you—from testifying concerning matters before the grand jury.

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You have not indicated that it forbids you to identify documents, is that correct?

Mr. Cavanaugh. I believe that's correct, sir.

Mr. Dingell. Can you explain to us, then, why you have refused in response to questions from me to identify documents?

Mr. Cavanaugh. Basically because it is part and parcel of an ongoing criminal investigation in the southern district of Florida. And under the rules and regulations as espoused to me at the Department of Justice——

Mr. Dingell. I did not ask you to identify these documents in relationship to their part in any ongoing criminal investigation in any part of the country.

My questions were what were the documents? Isn't that correct?

Mr. Cavanaugh. My only knowledge of the entire case is through my investigation of Pratt & Whitney, sir.

Mr. Dingell. I simply asked you to tell me what the document was and what it said.

Mr. Cavanaugh. The documents that I'm looking at here, yes, sir, I'll be happy to tell you what they are, you know, from what I see here.

Mr. Dingell. Were you instructed that you were not to identify documents, then?

Mr. Cavanaugh. I was never specifically instructed to do that; no, sir.

Mr. Dingell. I see.

Then why do you refuse to go beyond this in terms of identifying the documents?

Mr. Cavanaugh. Because some of this material that you have asked me to look at would be part and parcel of an investigation that is ongoing and would be connected with provisions of 6(e).

Mr. Dingell. You are not prohibited from telling me about that document by the provisions of 6(e), are you?

Mr. Cavanaugh. My interpretation or my understanding of our regulations is that anything that happens in the grand jury or as part and parcel with an ongoing Federal investigation in which a grand jury is used to obtain the records or documents, I am not at liberty to discuss.

Mr. Dingell. The gentleman from Minnesota?

Mr. Sikorski. Mr. Cavanaugh, that investigation was noticed that it should have been closed by now, and is simply not closed by—because you are waiting for discretionary action from Justice, either a request for additional investigation or movement ahead; isn't that correct?

How long are you going to wait?

Mr. Cavanaugh. I can't answer that, sir.

Mr. Sikorski. Were any limitations placed on—you said you were allowed to testify that you were awaiting those things. Are you allowed to testify about how long this wait is going to occur?

Mr. Cavanaugh. That's not a decision up to me, sir. That would have to be made in conjunction with FBI Headquarters and the Department of Justice.

Mr. Sikorski. I guess my question is: Are you aware of any time limitations on that wait?

Mr. Cavanaugh. I am unaware of any, sir.

Mr. SIKORSKI. Are you aware of the statute of limitations on this?

Mr. CAVANAUGH. Fully, sir.

Mr. DINGELL. Excuse me. What is that statute, please?

Mr. CAVANAUGH. Five years.

Mr. DINGELL. Thank you.

Mr. SIKORSKI. Five years from the billing?

Mr. CAVANAUGH. Yes, sir, when the claim was submitted.

Mr. SIKORSKI. And you looked at 1981 and 1982 billings?

Mr. CAVANAUGH. 1981.

Mr. SIKORSKI. 1981 billings? Are you a little anxious?

Mr. CAVANAUGH. I would rather not comment on that, sir.

Mr. SIKORSKI. Well, I am. I'm a little anxious about the gag order that has been imposed upon you, and a little suspicious, as well. You know, we are in kind of the same business as you are, and many of us in prior life were in the discovery business and asked questions to get answers and apply experience and human nature and hunches and intuition, and biases and prejudices and suspicions; and I am a little suspicious of what has occurred here.

Who did Mr. Revell talk to at Justice about this?

Mr. CAVANAUGH. I do not know.

Mr. SIKORSKI. How about Mr. Helterhoff? Did he imply or inform you in any way as to who he talked to at Justice about this matter?

Mr. CAVANAUGH. No, sir.

Mr. SIKORSKI. How about—do you know if Mr. Meese is informed of your presence, your subpoena or the restrictions that have been placed upon you by your superiors?

Mr. CAVANAUGH. I have no knowledge of that whatsoever, sir.

Mr. SIKORSKI. How about his assistants or deputies?

Mr. CAVANAUGH. My own personal knowledge, I have none, sir.

Mr. SIKORSKI. Have you heard of other people's personal knowledge? Have they intimated to you in any way, shape or form that there were communications with Mr.——

Mr. CAVANAUGH. Not that I recall, sir.

Mr. SIKORSKI. And anyone from the Criminal Section over there at Justice?

Mr. CAVANAUGH. No, sir. I have no personal knowledge of that.

Mr. SIKORSKI. How about Government Relations? Anyone over there who deals with or tells you who sits where and those kinds of things?

Mr. CAVANAUGH. No, sir.

Mr. SIKORSKI. Mr. Cavanaugh, I share with you, I think, a conclusion that you would make if you were sitting on this side, and that is something doesn't seem right about this process. Not only is it an affront to the oversight investigative process and, very probably, a violation of law; but beyond that, it smells.

I want to share the Chairman's appreciation of your diligence in the time that you spent on this case and commend you for your dedication in that effort, but I think we are up to the point where we can draw some conclusions. But we are prevented from that due to the action of your superiors and those at Justice and wherever else these restrictions were placed on you. From that, I think average people can conclude that someone doesn't want you to talk, for a reason that has little to do with advancing public information, good policy, and has more to do with protecting some people who didn't do right a few years ago.

I thank you for your past actions.

Mr. DINGELL. Are there further questions?

The gentleman from Alabama.

Mr. SHELBY. Thank you, Mr. Chairman.

How long have you been an FBI agent?

Mr. CAVANAUGH. I entered on duty May 16, 1971.

Mr. SHELBY. What is your educational background?

Mr. CAVANAUGH. Bachelor of science degree in education and international law. I attended law school but did not qualify for the bar. I was a police officer.

Mr. SHELBY. Have you had courses in accounting?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. Have you had occasion to know Mr. George Spanton? Is that his name?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. Have you worked with him on many occasions in your official capacity as a resident FBI agent in West Palm Beach, FL?

Mr. CAVANAUGH. Only on this investigation.

Mr. SHELBY. On the investigation of Pratt & Whitney?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. And when did you first meet Mr. Spanton?

Mr. CAVANAUGH. October 1982. He was introduced to me by an investigator for the Defense Criminal Investigative Service.

Mr. SHELBY. And that was about when the investigation or your part commenced regarding the Pratt & Whitney Division of United Technologies?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. And how long did you work with Mr. Spanton regarding your criminal investigation of this case?

Mr. CAVANAUGH. Since that time, sir.

Mr. SHELBY. Are you continuing to see him? Have you seen him lately?

Mr. CAVANAUGH. I have had conversations with him on the phone, yes, sir.

Mr. SHELBY. So, since October 1982 and up to the present time, you have seen him and worked with him more or less continuously?

Mr. CAVANAUGH. Toward the latter, sporadically, because Mr. Spanton has retired from the Agency.

Mr. SHELBY. Is he also a witness before this grand jury, the ongoing grand jury in Florida?

Mr. CAVANAUGH. I cannot comment on that, sir.

Mr. SHELBY. Do you know of your own knowledge that he is or was, before he retired, if you say he is retired, an auditor with the Defense auditing?

Mr. CAVANAUGH. He was the head auditor and supervisor of the audit team.

Mr. SHELBY. The audit team looking into the cost and the bills and the invoices and everything that were submitted by Pratt & Whitney, which is subject to this investigation?

Mr. CAVANAUGH. That's correct, sir.

Mr. SHELBY. How long has Mr. Spanton been retired?

Mr. CAVANAUGH. A year and a half. I don't know for sure, sir.

Mr. SHELBY. Let's go back to the ongoing investigation. Without getting into the details of it, and I understand your predicament here today, is there a Justice Department task force that is involved in this or is it the local U.S. attorney?

Mr. CAVANAUGH. It is the local U.S. attorney; however, the investigation is being aided by a team effort.

Mr. SHELBY. From the Justice Department here in Washington?

Mr. CAVANAUGH. No, sir, from the U.S. Air Force Office of Special Investigations, DODIG, and Defense Criminal Investigative Service.

Mr. SHELBY. You have been instructed by your superior, that you have related 1 minute ago, on many occasions this morning, that your immediate superior with the Federal Bureau of Investigation instructed you what to do here today; is that correct?

Mr. CAVANAUGH. He is not my immediate superior.

Mr. SHELBY. OK. One of your superiors.

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. Is he a ranking superior, if you want to call it, with the Federal Bureau of Investigation here in Washington?

Mr. CAVANAUGH. Yes, sir; he is.

Mr. SHELBY. And in the order of rank after Mr. Webster, what would he be?

Mr. CAVANAUGH. I would put him No. 3.

Mr. SHELBY. No. 3. And did you have a conversation with him regarding your testimony that you were supposed to give here today?

Mr. CAVANAUGH. I have met with him, yes, sir, concerning the subpoena that we had, and what could I say and what could I not say, to the extent possible.

Mr. SHELBY. Have you talked with the presiding judge there in the Federal District Court in West Palm Beach, FL regarding this?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Have you talked with the U.S. attorney in West Palm Beach, FL, who is carrying on the grand jury investigation of Pratt & Whitney? Have you talked with him regarding your subpoena and your possible testimony before the subcommittee?

Mr. CAVANAUGH. Only to the extent that we were required to advise him when we received such a subpoena.

Mr. SHELBY. And was that just a short conversation?

Mr. CAVANAUGH. A short conversation.

Mr. SHELBY. And did he tell you not to say certain things? Did he advise you of rule 6(e), the secrecy of proceedings and disclosure under the U.S. Code?

Mr. CAVANAUGH. It was reiterated, but I was already aware of it.

Mr. SHELBY. Have you, during the 12 years that you have been stationed in south Florida—I believe that was the time you said—in your entire tenure as an FBI agent, have you been put under these kind of gag orders before?

Mr. CAVANAUGH. Yes, sir. It is not that uncommon. We do not discuss ongoing investigations.

Mr. SHELBY. Is this the first time you have appeared before an investigative committee of the U.S. House of Representatives or the U.S. Senate?

Mr. CAVANAUGH. Most definitely.

Mr. SHELBY. Did you recommend, after your investigation beginning in October 1982, and completed, I think, according to your words, in the summer of 1984, a further investigation by the grand jury?

Mr. CAVANAUGH. I cannot comment on that, sir.

Mr. SHELBY. Did you submit your investigative results to the U.S. attorney's office in West Palm Beach, FL?

Mr. CAVANAUGH. He is aware of the status of the investigation, sir.

Mr. SHELBY. Have you testified before the grand jury in West Palm Beach, FL regarding this ongoing investigation?

Mr. CAVANAUGH. I cannot comment on things before the Federal grand jury.

Mr. SHELBY. I didn't ask you to comment on it. I asked you had you testified or been involved in the grand jury proceedings.

Mr. CAVANAUGH. Yes, sir. I will respectfully decline to answer that one, please.

Mr. SHELBY. Were you told by your superior not to even admit that you were involved in any way as a witness before a grand jury investigating Pratt & Whitney?

Mr. CAVANAUGH. I was not so instructed by any of my superiors. It is my decision on that, sir.

Mr. DINGELL. Will the gentleman yield?

Mr. SHELBY. I will yeild.

Mr. DINGELL. When you met this morning at 9 o'clock with Mr. Revell and others, was 6(e) of the Rules of Criminal Procedure discussed?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. Were you presented with a copy of it at that time?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. Were the provisions of that rule defined to you at that time by any person?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. Nobody said: the rule says this or the rule says that?

Mr. CAVANAUGH. No, sir.

Mr. DINGELL. How did you know what you were instructed to do in terms of complying with 6(e)?

Mr. CAVANAUGH. Because I am the case agent on this investigation as well as numerous others, and I have operated under the provisions of 6(e) since its inception.

Mr. DINGELL. Have you ever operated under 6(e) with regard to limitations it would impose upon you in connection with your appearance before a congressional committee?

Mr. CAVANAUGH. This is the first.

Mr. DINGELL. Did you ask anybody, in connection with your discussions this morning, about the limitations on your presentation this morning which would be imposed by 6(e) in view of the fact you are appearing before a congressional committee?

Mr. CAVANAUGH. No, sir, I did not.

Mr. DINGELL. You did not.

What were Mr. Revell's precise instructions to you in connection with your appearance here? I want you to quote his exact words.

Mr. CAVANAUGH. I cannot recall his exact words, sir.

Mr. DINGELL. Come as close as you can.

Mr. CAVANAUGH. Contained in the statement.

Mr. DINGELL. No, I am asking you what were his exact words, as best you can recall them.

Mr. CAVANAUGH. I cannot recall his exact words, sir.

Mr. DINGELL. Well, it occurred at 9 o'clock.

Mr. CAVANAUGH. Yes, sir; but I couldn't tell you what his exact words were. I'm not meaning disrespect.

Mr. DINGELL. It occurred at 9 o'clock this morning. You were aware of the fact that the committee wanted to hear your testimony in this matter, weren't you?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. You were aware of the fact that you were being placed in the position of some personal and professional peril by this, were you not?

Mr. CAVANAUGH. I don't see it in that light. I don't see it in the light you just said. I honored the subpoena. I would do that with a court.

Mr. DINGELL. You have honored the subpoena, but you knew the subpoena required a series of things from you, one of which was your presence, and the other one which was your testimony. You have chosen to be present, but your testimony has been less than complete.

You didn't assume that this was a frivolous enterprise upon which you were engaged or which the committee was engaged, did you?

Mr. CAVANAUGH. Never, sir.

Mr. DINGELL. So, given that circumstance, didn't you assume that your presence here was going to impose upon you the duty to understand very clearly your instructions?

Mr. CAVANAUGH. Yes, sir.

Mr. DINGELL. So then, I assume you made a more than ordinary attempt to understand those instructions.

Mr. CAVANAUGH. I believe so.

Mr. DINGELL. And to remember the instructions.

Mr. CAVANAUGH. Remember the substance of the instructions, yes, sir.

Mr. DINGELL. All right, then. What were the instructions? As close to the exact words as you can.

Mr. CAVANAUGH. I'm not authorized to testify concerning the substance of the investigation, nor am I authorized to respond to questions concerning FBI policy. I have no authority to release FBI documents, and that rule 6(e) of the Federal Rules of Criminal Procedure prohibits me from testifying concerning these matters that occur before the grand jury. And that within those limitations, he instructed me to cooperate and try to answer whatever questions I could, sir.

Mr. DINGELL. Were the provisions of 6(e) ever defined to you so you would know what 6(e) meant?

Mr. CAVANAUGH. Not this morning, sir.

Mr. DINGELL. Were they in any of your other discussions with the U.S. attorney or deputy U.S. attorneys or associate U.S. attorneys in Florida?

Mr. CAVANAUGH. Not lately, sir. You know, over the course of the years I have.

Mr. DINGELL. The Chair thanks the gentleman.

Mr. SHELBY. Mr. Chairman, I am recalling my time.

I want to get back into the people in the FBI here other than Mr. Webster, and let's see if I understand the pecking order. Mr. Webster is the Director of the Federal Bureau of Investigation. He is No. 1. Is that correct?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. Who is the No. 2 man?

Mr. CAVANAUGH. Lee Colwell.

Mr. SHELBY. And who is No. 3?

Mr. CAVANAUGH. I would say Oliver Revell.

Mr. SHELBY. And what is his specific title?

Mr. CAVANAUGH. Assistant Director in charge of the Criminal Division.

Mr. SHELBY. Assistant Director in charge of the Criminal Division of the Federal Bureau of Investigations nationally, the Washington office.

Who is in charge of the FBI office in West Palm Beach, FL?

Mr. CAVANAUGH. Bob Neumann.

Mr. SHELBY. Is he your immediate superior?

Mr. CAVANAUGH. Yes, sir.

Mr. SHELBY. And how many FBI agents do you have currently assigned there, if you know? I know it fluctuates.

Mr. CAVANAUGH. Approximately 12 to 14.

Mr. SHELBY. Did you have a conversation or instructions from your immediate superior there in the FBI office in West Palm Beach regarding whether to testify or not to testify before this Subcommittee of Oversight and Investigations?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Did you discuss it with him?

Mr. CAVANAUGH. No, sir; the fact that the subpoena existed, yes. He was advised of that. But as far as what to testify to, no, sir.

Mr. SHELBY. OK. How did Mr. Revell, the No. 3 man, how did he get involved in this all at once? Did you call him?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Well, how was the information disseminated to him, such a high position with the Federal Bureau of Investigation, the No. 3 man in the whole Bureau, that you were going to appear before this subcommittee today? Do you have any idea how that came about?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Were you told to report to him when you came to Washington?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Well, did you see him on the street or what?

Mr. CAVANAUGH. No, sir; I reported to FBI headquarters.

Mr. SHELBY. OK. Did somebody tell you to report to him, then?

Mr. CAVANAUGH. We ultimately did, yes, sir.

Mr. **Shelby**. You ultimately did. In other words, you reported to someone, and then ultimately you reported to the number three man in the Federal Bureau of Investigations.

Mr. **Cavanaugh**. Yes, sir.

Mr. **Shelby**. And was this man—this Mr. Revell, was he the gentleman who instructed you not to testify before this subcommittee because of the ongoing Grand Jury investigation?

Mr. **Cavanaugh**. He did not tell me not to testify.

Mr. **Shelby**. What did he say to you?

Mr. **Cavanaugh**. To testify within the limitations.

Mr. **Shelby**. Did he define those limitations?

Mr. **Cavanaugh**. He did, sir.

Mr. **Shelby**. Did you have any counsel with the Federal Bureau of Investigation down there to further elaborate on what that meant?

Mr. **Cavanaugh**. There were other individuals in the room, as I set forth.

Mr. **Shelby**. The gentleman seated at the table, is he an attorney?

Mr. **Cavanaugh**. I do not know. I assume so.

Mr. **Shelby**. Is he your attorney for the day, assigned to you?

Mr. **Cavanaugh**. Yes, sir; he is here from the Bureau.

Mr. **Shelby**. And did you know him prior to today?

Mr. **Cavanaugh**. Yesterday.

Mr. **Shelby**. Is he advising you and counseling you during this hearing today regarding what he feels are the parameters that you should or should not testify to?

Mr. **Cavanaugh**. No, not really, sir.

Mr. **Dingell**. Not wait. No; or not really?

Mr. **Cavanaugh**. Not really. We had discussions this morning where Assistant Director Revell set forth the parameters of my limitations.

Mr. **Shelby**. Well, what is he doing here? Is he getting water for you? Is he going to get you coffee, or what? What are his duties here today if he is not advising you as counsel?

Mr. **Cavanaugh**. I would say he is advising as counsel.

Mr. **Shelby**. OK. That's what I was trying to get at.

Mr. **Dingell**. Will the gentleman yield? Has he provided to you the provisions of rule 6(e) or what duties that imposes upon you?

Mr. **Cavanaugh**. Has who, sir?

Mr. **Dingell**. Has the gentleman in question advised you of the content or the requirements of 6(e) insofar as they dictate your conduct and your appearance before the committee today?

Mr. **Cavanaugh**. No, sir; he has not.

Mr. **Dingell**. Thank you.

Mr. **Shelby**. Have you had any conversation with Mr. Ed Meese, the U.S. Attorney General, regarding your appearance here today?

Mr. **Cavanaugh**. No.

Mr. **Shelby**. Have you had any conversations regarding—or with anyone else in his office here?

Mr. **Cavanaugh**. No, sir.

Mr. **Shelby**. Do you know Mr. Meese?

Mr. **Cavanaugh**. No, sir.

Mr. **Shelby**. Do you plan to go to the Justice Department, other than the Bureau, after you leave here today?

Mr. **Cavanaugh**. No, sir.

Mr. **Shelby**. Would you, when you are through here, will you go back to West Palm Beach, FL?

Mr. **Cavanaugh**. I hope to, yes, sir.

Mr. **Shelby**. Well, we hope you do go, but not yet.

Were you surprised or was anybody surprised, especially you, when you were told of the restriction on your testimony here? In other words, when you were told that you really shouldn't testify as to what was going on in the investigation of Pratt & Whitney that you had been involved in for the past 2 years, did that surprise you in any way?

Mr. **Cavanaugh**. No, sir.

Mr. **Shelby**. It didn't? Do you believe that an ongoing committee such as this Oversight and Investigations has a right to some of the testimony that you are withholding?

Mr. **Cavanaugh**. That's not a decision for me to make.

Mr. **Shelby**. Well, you make decisions every day. Didn't you investigate, with the help of some auditors, the Pratt & Whitney business dealings with the Pentagon, and then you obviously made certain recommendations when you submitted your report to the U.S. attorney.

Mr. **Cavanaugh**. No, sir; we do not make recommendations.

Mr. **Shelby**. What do you do?

Mr. **Cavanaugh**. Just investigate and gather the facts and present them to the U.S. attorney's office.

Mr. **Shelby**. You don't make any recommendation?

Mr. **Cavanaugh**. I don't make any recommendations.

Mr. **Shelby**. Is it just cold testimony, no conclusions drawn?

Mr. **Cavanaugh**. We do not put conclusions, no, sir.

Mr. **Wyden**. Will the gentleman yield?

Mr. **Shelby**. I would be glad to.

Mr. **Wyden**. Just very briefly. Here is the situation. You are a Government watchdog, and you are effectively muzzled in the matter of a couple of hours. Don't you think that is a little bit out of the ordinary? Do you just find this very acceptable operating procedure, to be brought in just a couple of hours and effectively told that at a time when the American taxpayers are being bilked out of billions of dollars, you just can't say anything, and that is all there is to it?

Mr. **Cavanaugh**. I don't understand the question. I am going within the parameters that I have been given, sir.

Mr. **Wyden**. You didn't think it was anything out of the ordinary? You were brought in, you were effectively muzzled, and you didn't think there was anything out of the ordinary about that?

Mr. **Cavanaugh**. I don't see being muzzled.

Mr. **Wyden**. I think that should be obvious to anybody, that at a time when the chairman has asked very specifically for information that is outside of 6(e), to be brought in at the last moment in this kind of fashion and suddenly make a 180-degree turn on the nature of your appearance, you should want to know the legal authority and the specifics as to why it is done. I would think any

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agent would want to do it and anyone else who functions as a Government watchdog.

Mr. SHELBY. I am reclaiming my time.

Mr. Cavanaugh, you are an FBI agent of some how many years? A veteran of how many years?

Mr. CAVANAUGH. Fourteen years.

Mr. SHELBY. Fourteen years total. And I would assume from your record, and you are still there, and your participation in this investigation—notwithstanding the testimony today under a gag order—that you are interested in the truth, that you are a seeker through your investigation of the truth of what went on between Pratt & Whitney in their billings to the Pentagon regarding certain defense costs.

Is that a fair question?

Mr. CAVANAUGH. It's a fair statement.

Mr. SHELBY. And you are interested in this. You have been trained as an investigator and you are a Government employee with the Federal Bureau of Investigation. I assume that you want the taxpayers to be treated fairly in all respects; otherwise, you wouldn't be there.

Could you in any way on your own, notwithstanding what you were told, don't you feel like we ought to get some information out of you today that would aid us in a further investigation from the congressional perspective? Notwithstanding what is going on in the grand jury, or what has not gone on in the grand jury, maybe we should say.

Mr. CAVANAUGH. Again, I have no authority to do so, sir. The investigation is a result of the investigation of the FBI. I operate under that policy.

Mr. SHELBY. If you had not been told by the number three man with the FBI here or some others, would you have testified openly and freely here today?

Mr. CAVANAUGH. I still think I can testify freely, within the parameters that I know as my guidelines. I have not been authorized to disclose some information, to testify concerning the substance of the investigation.

Mr. SHELBY. Have you heard of Mr. A. Ernest Fitzgerald?

Mr. CAVANAUGH. I have heard the name, yes, sir.

Mr. SHELBY. Involved in the investigation of some $2 billion in overruns in the C-5-A program? And, of course, you know of President Nixon. He had, on one of his famous tapes, this comment: "I don't care if he complains about overruns." Mr. Nixon is speaking of Mr. Fitzgerald. "I don't care if he complains about overruns, but not in public." Does that sound familiar?

Mr. CAVANAUGH. No, sir.

Mr. SHELBY. Thank you.

Mr. DINGELL. The time of the gentleman has expired.

Before we adjourn, the Chair has just a few comments.

First of all, Mr. Cavanaugh, we are aware of the difficult position in which you find yourself placed today. The Chair wishes to observe that we will continue to pursue the information sought by the committee today, and the Chair wants to cite, by way of precedent here, the fact that this committee, through one of its subcommittees, the sister subcommittee of this, the Subcommittee on

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Energy and Power, in concert with a subcommittee of the Judiciary Committee, the Subcommittee on Crime, held extensive hearings which were widely reported on in the press and by an appropriate report and hearings.

Just to show the proper ability under the law of this committee to produce the necessary testimony, the committee had a number of officers of the Federal Government to testify in the proceedings on May 30 and June 4, 1979. There were, in instances involving the testimony of those witnesses, ongoing criminal investigations about which those witnesses testified.

The first witness was Mr. Dana E. Caro. He was Chief Inspector, Planning and Inspection Division, Federal Bureau of Investigation, Department of Justice. another witness was Mr. Richard M. Fishkin. He was with the Fraud Section, Criminal Division, Department of Justice.

Also present were: Mr. Joseph E. Henehan, Section Chief, White-Collar Crime Section, Criminal Investigative Division, Federal Bureau of Investigation, Department of Justice, Mr. John C. Keeney, Deputy Assistant Attorney General, Criminal Division, Department of Justice; Mr. Francis M. Mullen, Jr., Deputy Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation, Department of Justice; Mr. Marvin L. Rudnick, assistant U.S. attorney, Tampa, FL. Also, the Honorable J.A. (Tony) Canales, U.S. attorney for the Southern District of Texas.

In addition to that, we had Mr. Herbert F. Buchanan, Deputy District Manager, Enforcement, Department of Energy; Mr. F. Kevin Boland, Associate Director, Energy and Minerals Division, U.S. General Accounting Office; all of whom testified in extenso at that time on matters relative to ongoing criminal investigations into which our sister subcommitee inquired.

I just want you to understand that the powers of the subcommittee to procure the necessary information are not as limited as your instructions would indicate to you today. Because, however, we are aware of the peril that you have been placed in by the instructions of your superiors, it is the intention of the Chair to try and give understanding to the fact that you are a distinguished public servant who has a fine record in law enforcement, and to try and see to it that your appearance here today was conducted with all respect for your dignities and responsibilities; and at the same time to see to it that the necessary information is procured by the appropriate activity of the committee on the matters into which we now inquire.

In any event, as indicated earlier by the Chair, you will be excused. You will remain subject to the subpoena of the committee, and it may be that the committee in due course of time, for its responsible conduct of its duties under the rules of the House, will require your presence, and you will continue to regard yourself, Mr. Cavanaugh, under the process of the committee until and unless otherwise excused by the committee.

The committee thanks you, sir, for your assistance this morning. The committee will stand adjourned until the hour of 2 o'clock.

[Whereupon, at 12:40 p.m., the committee hearing was recessed, to reconvene at 2 p.m. the same day.]

[The following letters were received:]

U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

May 3, 1985

The Honorable William H. Webster
Director
Federal Bureau of Investigation
J. Edgar Hoover Building
Washington, D. C. 20535

Dear Judge Webster:

Enclosed is a copy of a transcript of a Subcommittee hearing held on April 23, 1985. Special Agent James Cavanaugh of the West Palm Beach Field Office of the Federal Bureau of Investigation appeared before the Subcommittee, in response to a Subcommittee subpoena. Mr. Cavanaugh was accompanied at the witness table by Emil Moschella. Based upon a statement handed to Mr. Cavanaugh one hour before the hearing commenced, he declined to provide the Subcommittee with necessary relevant testimony.

You are requested to review that portion of the transcript relating to Mr. Cavanaugh's appearance. Having done so, please advise the Subcommittee whether Mr. Cavanaugh's statements to the Subcommittee are accurate, and whether they accurately reflect the instructions he was given prior to his appearance. If Mr. Cavanaugh's testimony reflects a misunderstanding or confusion concerning those matters about which he could testify, please provide the Subcommittee with a statement of clarification which may be included in the record. That statement should include an appropriate discussion of the points raised by the Subcommittee in its questioning.

If Mr. Cavanaugh's testimony is correct, you are requested to advise the Subcommittee: (1) who gave these instructions and the identities of all individuals involved in the development and delivery of these instructions to Mr. Cavanaugh; and (2) what instructions, guidance, suggestions, advice or comments were provided, directly or indirectly, to the Bureau by anyone in the Department of Justice, and the identity of those persons in the Department, concerning Mr. Cavanaugh's appearance and testimony.

You are also requested to furnish the Subcommittee with a statement of legal principles and supporting legal memoranda for Mr. Cavanaugh's failure or refusal to testify based on any legal principles other than Rule 6(e) of the Federal Rules of Criminal Procedure. Your discussion should include consideration of the applicability of Section 192 of Title 2, United States Code and Section 1505 of Title 18.

Your prompt response to this Subcommittee is requested.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:MBcm

Enclosure

U.S. Department of Justice

Federal Bureau of Investigation

Office of the Director

Washington, D.C. 20535

June 20, 1985

RECEIVED

JUN 28 1985

Subcommittee on
Oversight and Investigations

Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in response to your May 3, 1985, letter to me. You asked several questions concerning the appearance of Special Agent (SA) James Cavanaugh before your Subcommittee.

You asked specifically about the instructions given SA Cavanaugh prior to his testimony. After learning that a subpoena had been issued, Assistant Director Oliver B. Revell was advised that the information about the case was in large measure within the scope of Rule 6(e) of the Federal Rules of Criminal Procedure or was intertwined with material so encompassed. He also considered Department of Justice policy on testimony about pending investigations. That policy has as its purpose the protection of the integrity of the investigative and prosecutive process. After consulting with Legal Counsel and Assistant Attorney General Stephen S. Trott, Mr. Revell instructed SA Cavanaugh to appear before the Subcommittee. He told him to answer all questions except those questions the response to which would disclose information protected by Rule 6(e) or disclose the details of a pending investigation. He also instructed SA Cavanaugh that he could not produce any records because he is not the custodian of records. In my judgment, Mr. Revell's instructions were correct and proper.

Throughout my tenure as Director of the FBI, I have tried to cultivate a relationship with the Congress marked by candor and cooperation. I would like to maintain that posture in this situation. To that end one of my representatives, J. Kevin O'Brien, has discussed with your staff ways in which your interests and ours might be accommodated.

The transcript of SA Cavanaugh's testimony, which you enclosed with your letter, has been returned to the Committee under separate cover.

Sincerely yours,

William H. Webster
Director

AFTER RECESS

Mr. **Wyden** [presiding]. The subcommittee will come to order.

Our next witness is Mr. George Spanton, the former resident auditor of the Pratt & Whitney Government Products Division of United Technologies Corp., West Palm Beach, in FL.

Mr. Spanton deserves a good deal of credit along with his fellow auditors for ferreting out most of the fraudulent billings under trying circumstances.

Mr. Spanton, if you would come forward. I think you are aware that it is the practice of the subcommittee to swear our witnesses. Do you have any objection to being sworn, Mr. Spanton?

Mr. **Spanton**. No, sir.

[Witness sworn.]

Mr. **Wyden**. Mr. Spanton, you are also to be advised that it is the subcommittee rule that you would have at all times a copy of both the rules of the Committee and the rules of the House with you. And with that notification, we look forward to your statement.

We will make a copy of your prepared remarks a part of the record in it's entirety.

Feel free to make any comments you deem appropriate.

STATEMENT OF GEORGE R. SPANTON, FORMER RESIDENT AUDITOR, PRATT & WHITNEY GOVERNMENT PRODUCTS DIVISION, WEST PALM BEACH, FL

Mr. **Spanton**. Would you prefer that I read my statement, or just present it for the record?

Mr. **Wyden**. Whatever you would deem appropriate. We will make a full copy of your remarks a part of the record. And, if you care to, just highlight your principal concerns in your statement today.

Mr. **Spanton**. Yes, sir.

I want to thank you and the committee for inviting me here today, and I appreciate the opportunity to talk about my experiences while resident auditor at Pratt & Whitney's Government Products Division in West Palm Beach, FL.

I hope my experiences will shed some light on the current problems in the Defense Department's Acquisition and Auditing Agencies. The problems, I feel, contribute to a climate that encourages companies like Pratt & Whitney and General Dynamics to try and charge the Government for outrageous overhead expenses. The truth is, they are often successful, and the result is millions of wasted tax dollars per year.

Several months ago, this committee thought me sufficiently knowledgeable of Defense Department auditing practices, that they called me out of retirement to assist them in their investigation of overhead abuse by General Dynamics. Once again, I am most happy to be of service to you.

My last assignment was audit manager at Pratt & Whitney. I also had responsibility for over 100 companies in south Florida, as well as overseas. The bulk of our work during my assignment to Pratt & Whitney was, of course, requiring about 75 percent of my time.

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I have had prior years' experience with DCAA from 1967 forward. Prior to that time I was a manager with the Navy Audit Service since 1954.

My entire career with the Government was as a manager and supervisor.

It appears that my most serious clashes with DCAA, the Air Force and Pratt & Whitney began in 1981, although I have had difficulties from time to time, because auditing is a tough job. But, since 1981, I had serious problems with Pratt & Whitney because of the issues being raised and the major dollars involved.

One of the areas where I feel was a turning point in my career with the agency arose, was during an audit of travel, entertainment expenses. We uncovered, amongst outrageous charges—truly outrageous in my experience, let me add this, with the audit services. It seems from 1981 forward, these costs just got out of hand. And, in 1981 we uncovered information that the contractor, contrary to the laws and regulations, was entertaining Government personnel, military and civilians.

During the same timeframe, we began an audit of the escalation of labor costs. We considered that this was a key audit because it was a tough economic period. Many of the major industries were having layoffs or there were salary freezes and rollbacks. And yet we noted at Pratt & Whitney and other major defense contractors, these escalations were going on as though there were no economic hardships. And, of course, this was possible because they were working with a defense budget. Over the period there were not limitations on how much these contractors could spend.

However, based on our beliefs that there should be some limitations exercised over Department of Defense contractors, we initiated these audits and made recommendations to the procurements authorities that salaries ought to be controlled. And we pointed out that during a 3-year period, approximately $150 million of costs could be saved at this one plant alone.

There were some discussions and disagreement as time went on, as to the exact amounts that could be spent. I know that GAO got involved, and we had lengthy discussions with GAO. There was a difference in philosophy. But, nevertheless, as auditors we had the responsibility to make the determination on reasonableness. And, we considered it reasonable to control costs.

I think the GAO approach was, there had to be some kind of law or regulation that would permit us to do this.

Nevertheless, that, I think, was a key audit together with the audit that we did on travel and entertainment expense, including the entertainment of military personnel. It was at that point in time that I noticed a hardening in our relationships with both the Air Force, the contractor and my own organization.

It became necessary, because of the information that we had uncovered in the travel and entertainment audit, to make a recommendation that the audits and the information that was developed, be turned over to some investigative agency to develop further information on the events that had taken place involving military and other Government officials where we felt that there were violations of the law. And we had made this recommendation as outlined in our own regulations through channels.

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However, our recommendation for an investigation was stalled at the first tier, which was the regional headquarters, and we couldn't seem to get it off the ground. They asked for additional data, and they went back and forth. It was mostly administrative—while the guts of what we were trying to get across was totally ignored.

It was at about that point in time that it was determined that I should be investigated. And I was visited by a Defense criminal investigation man who stated that he had some complaints about me and my involvements with Pratt & Whitney. In fact, as he put it, I was soft on the contractor.

I thought it might have been the other way around. But, that was his explanation for the investigation of me and my audit operation.

He proceeded on his investigation. His name was John Batson. He proceeded with his investigation for several weeks, and then he came back to the office and indicated that he didn't have to read me my rights, as he first indicated he might have, and that I was, as he put it "off the hook."

I indicated to him this evidence of wrongdoing that we felt we had uncovered, at least while we were not lawyers, we felt there were some questions about the legality of certain of these expenditures that we had uncovered. And it was this individual that bypassed my agency and went directly to the FBI and was instrumental in getting the investigation going.

During the same timeframe, it was determined by my agency that my services were needed out in California. Despite the fact that I still had several years under the rotation program to work at Pratt & Whitney, they felt that, as they put it to me bluntly, I really didn't get along well with the region, I didn't think like others in the region. I always had problems with the region.

Very frankly, I had problems with the region because I was always critical of the quality of DCAA audits.

One of the most important areas of responsibility that no other manager has, is to provide his auditors with the working tools to do a job. This means records and documents. And then it is the responsibility of the auditor to use these records effectively. And this was not just being done in the Defense Contract Auditing Agency.

The rule seemed to be that auditors had to make a determination on just how much material they needed; at the same time they had the responsibility to be reasonable. You have to put that word "reasonable" in quotationmarks, because it was left open for interpretation.

As an example, I recall a discussion with the regional director on a major defense contract in south Florida where the auditors were having problems with getting records. And I went in and suggested that we either cut our reimbursement of all costs, or just discontinue the audits until such time as we got the records.

His resolution of the problem was, well, if you can't get them all, get as much as you can and work around the rest.

Again, this is the philosophy that exists within the Department of Defense Contract Auditing Agency, and in my mind is one of the key explanations for the issues being raised today as far as the quality of audits, the excessive costs being incurred, and excessive manpower being employed at these various plants.

However, because I raise these issues where I said the agency had compromised the responsibility, I had crossed swords. And again, they didn't beat around the bush. They put it bluntly to me that I was not a team player, that I was creating issues with procurement officials. I was creating issues with defense contractors, and why don't I just try harder to be reasonable.

And I tried to explain in as nice a way possible, that my responsibility as a professional auditor was to do the job that I felt I was doing.

This led to further activities on the part of the agency to attempt to have me removed. It was about that point in time that I enlisted the services of the Office of Special Counsel.

To get into the meat of the types of expenses that we are talking about here, when I worked in General Dynamics to assist the committee, I saw what I considered outrageous charges in the overhead accounts. However, they were not unusual. It is not that I had not encountered them before. In fact, I considered them quite usual, because I had seen the same thing at Pratt & Whitney, and I had seen them, though on a lesser scale, at some of these smaller contractors. And while I was a supervisor within the Defense Contract Audit Agency, covering all contractors in Florida, I saw somewhat the same situation.

And, to put it bluntly, the overhead accounts are a dumping grounds. A contractor will put into these accounts whatever he pleases, and whatever the auditor can uncover may be questioned. And I say may be, because the auditor is simply advisory to—and again I will put this in quotation marks "his clients" which is procurement.

He makes a simple recommendation to procurement, and they can totally disregard it if they wish. And very often that happens.

I found that I was not able to make any headway on many of the complaints I had as far as the failure of my agency to correct the deficiencies within their own operations. They seemed to be more interested in reporting costs sustained, cost questions, cost avoidances, operations audits with theoretical cost savings. In other words, statistics. And what organization should be better at developing statistics than an audit agency. And they did a good job.

But much of that time in developing the statistics, we were taking away from our true mission which was to do these effective audits.

So I was critical of the relationship that the auditors had with defense contractors and their so-called clients, the procurement activities.

I felt that we should be at arm's length and we shouldn't be evaluated as the system provided on our ability and our relationships to get along with these people.

Their theory was the better you got along with the clients, procurement, and the contractor, the better auditor you were. And so there was a wide division of opinion as to how audits should be performed, and I expressed my views openly. And again, this was considered a serious challenge because I have heard that within the agency, I have heard it from the Air Force, you don't challenge the system. You work within the system. You might suggest changes. If the changes don't come about, you go along with the system as it exists, but you certainly don't expose system deficiencies to anybody outside the system.

And it was during that period of time that I did go outside and I felt with the millions or billions involved throughout the Nation, where the conditions were just carbon copies of what I knew what existed at Pratt & Whitney at that time, and that I subsequently saw at General Dynamics, only individuals who are on the inside and are unaware that this is a pervasive situation throughout the Defense Department are not keeping up with the actual situation.

I cannot be shocked at what I saw at General Dynamics. Yes, I am concerned, but not surprised, because I have seen it so often before. And I have seen—it just seems like the Government, the Department of Defense, puts on a show of helplessness to cure all of these deficiencies that do exist.

For example, corporate aircraft, a problem at General Dynamics, a problem at Pratt & Whitney. It has existed as long as the agency has existed, and there were always promises that this problem would be corrected.

Nevertheless, they continue to incur these unnecessary costs which may be 10 to 15 times the cost of commercial flights, commercial transportation.

Even if the auditor questions it, most often a substantial portion of these costs are reinstated, and they are reinstated without explanation. Very often the auditor becomes intimidated by the actions of the procurement people when they negotiate these costs back in, and just shrug and say: "Well, I questioned it last year and the year before, and the contractor gets paid, so I'm not going to bother this year. I will look elsewhere."

Travel for spouses. I think that's an outrageous charge to Government contracts. The contractor puts it in, figuring first the auditor has to find it, and then he has to make a decision on whether he is going to question it or not, and if he does question it, the odds are pretty much in my favor I will get some portion of it when I negotiate it. And it seems like the thought never enters his mind as to the question of legality. It seems like the DAR or FAR or whatever regulation you want to refer to has been written with a loophole, with an out.

When you read some of these regulations, they might go on paragraph after paragraph and you feel like you have a working tool until you get to the last paragraph which says, "However," and that opens the door.

And again, every defense contract I have seen uses these loopholes. I have heard CAS 405 mentioned. Fine. But the defense contractors say: "We don't recognize any of these costs as unallowable until they get thrown out in final negotiations, unless we take it to court."

I have been on many talk shows since my retirement around the country, radio talk shows. It seems like the people around the country know what's right and what's wrong. They hear about some of these outrageous costs and there's no question in their minds that they should not be charged. But these learned officials who head up these major defense contractor organizations don't seem to be tuned in to the same facts. Anything goes.

Unfortunately, my own audit agency takes somewhat the same view. I wasn't told firsthand, but I was given the understanding that my own agency had the view, "Let the contractors charge whatever they feel they should, and it's up to the auditors to find it."

There are literally millions of transactions and very few auditors. And to put the burden on the auditors to find these types of costs is literally an impossible task. We find some and then the some that you find are the ones that are negotiated.

The Washington office expenses. Very much in common, whether you're talking about Pratt & Whitney or General Dynamics. When they are audited—and again I have to use that term loosely—the audit most usually, if they are permitted to audit, consists of a questionnaire to these officials. "What do you do with your time?" Very often the officials find that perhaps 5 percent of their time is spent lobbying. In all the years that I had been in my capacity, I see no useful purpose served by the Washington offices of these various major defense contractors, other than to lobby. They have memberships in country clubs, they are out on the golf course and tennis courts, or they are watching the Redskins play.

I really have had difficulty in determining what kind of work they do that the Government is reimbursing. And the costs are significant. The allocations of Pratt & Whitney down in Florida alone, I believe it was 1981 and 1982, ran close to $1.2 million. That's just an allocation. I don't know what the total costs were.

So, the costs are significant. Yet, many of these major defense contractors have these operations, and nobody seems to be concerned about eliminating these costs. Some portion is questioned, and very often a good portion of the questioned costs are reinstated. Most often that happens.

We have attempted in our audit operation in south Florida to do professional audits and turn out the information that's presented in this writeup here, but it's easy for me to tell you firsthand the problems that exist in the defense acquisition community, in the military-industrial complex are not difficult to solve. You just need to resolve to do it.

I found it's not only the contractors in DCAA management that are blamed for contributing excessive procurement costs. At any contractor location the interest of the Government is represented by the service's plant representative office.

From my experience I observed that too often Air Force plant representative sees his role as a partner with the contractor. He is concerned with maintaining a harmonious relationship and getting along with the contractor, rather than challenging him. AFPRO representatives are particularly vulnerable to the revolving door syndrome. Several of the predecessors of the current Pratt & Whitney AFPRO went to work for the company after retiring from the military, either as full-time employees or consultants.

Again, I name Pratt & Whitney, but I know virtually every defense contractor has been served well in this revolving door syndrome.

In fact, a standing joke to some of them is that if they—if all the retired military wore their uniforms, you'd think you were in the Pentagon.

Nevertheless, these hiring practices continue.

In my case, the Air Force's concern for the contractors even extended to attempts to have me removed as resident auditor because of fear that my audits and discussion of them with the media would embarrass the Air Force.

In 1983, the AFPRO commander, Colonel Roberts, was investigated by the Air Force inspector general for attempting to have me removed from my job. While the Air Force IG found that Colonel Roberts did nothing overt or official to have me transferred or fired, the Defense Department investigator on the case, John Batson, told the Air Force IG that Colonel Roberts had suggested to him that he, Batson, go to my superior in an effort to have me removed or dismissed. The Air Force staff judge advocate at Pratt & Whitney, Capt. Jeffrey Rohm, told the Air Force IG that he had often heard the colonel privately express the wish that I be removed.

Indeed, another of my superiors, Alvin Tueller, told the Air Force IG that Colonel Roberts also expressed this opinion to him, that I be removed. According to Mr. Tueller, Colonel Roberts even volunteered to put his opinions in writing to DCAA managers.

Also revealing was the response of Colonel Roberts to a question about the release of a very controversial report my office had issued on the high salary increases granted to contractor employees, particularly the contractor executives. The executives' salaries were found to be 40 to 45 percent higher than private industry, and this is besides those perks including the leased vehicles.

Colonel Roberts was very upset that the report might be leaked to the press. The suspicion was that I would be the source of that leak. Colonel Roberts stated:

> I don't want to do anything that will embarrass the Air Force, and don't take that as that somebody's going to cover something up to keep from embarrassing the Air Force, but I think we have an obligation today to the American public to, not to embarrass the Department of Defense because that has a major impact on the budget that we get, some of these things. So, in that context, yes, I didn't want something that needed further review or further refinement or further work to go out and be used against us.

I think Colonel Roberts' statement makes it clear that the priorities of the Air Force are to protect its image and, more importantly, the flow of money. It is not whether the Air Force is getting the best product at the best price, but whether or nor the budget can be increased that drives the procurement process.

I was in trouble with DCAA and the Air Force because our philosophies simply did not match. In the current climate, those who want to save money are punished, those who spend it are rewarded.

I will talk about a few more items in this, and then I will be open for questions.

But this again brings out the type of costing that we encountered.

Pratt & Whitney has the most modern computer equipment for recording financial transactions. Nevertheless, in 1981 and 1982, Pratt & Whitney charged the Government over $1 million each year for Washington costs associated only with its Government products division. I am not aware of how much of the money claimed by the contractor was considered allowable by DCAA.

In 1983, my staff found evidence that Pratt & Whitney double-charged the Government. It charged twice for its Washington office costs; that is, it twice claimed reimbursement of approximately $920,000.

We also found that over a period of several years the company duplicated $2.9 million in various general and administrative expenses. That $2.9 million did include some Washington office costs.

Because of the circumstances surrounding these double billings and the contractor's unsatisfactory response to our inquiries, I referred the matter to DCAA headquarters as suspected irregular conduct and requested an investigation by an outside agency.

The DCAA, in transmitting my request for an investigation, deleted a substantial portion of my report. Instead, they submitted a modified version over my signature. I have no explanation as to why they doctored my report, but I am still troubled by it. I do not know if their action in any way influenced a decision to look into the situation by an investigatory agency to see if there was an intent to defraud the Government.

What I do know is that the double-charging was acknowledged by the company and the money was repaid. However, Pratt & Whitney tried to make it appear as if they, and not my staff, had uncovered the abuse.

I would be happy to furnish additional information on this if the committee requests it.

On the subject of profits, a very key issue, recently the New York Times reported that the average profit on equity enjoyed by the country's top 10 defense contractors was 25.6 percent, a much higher rate than that earned by most companies in the private sector.

This is another area of potential abuse, yet DCAA auditors are discouraged from questioning contractors' profits. I have included as attachment B a 1982 DCAA memo in response to a request for guidance on contractor profit. That response cited agency regulations to the effect that unless such information is requested by the contracting officer, the auditor will not attempt to do anything further in the profit area.

I feel this is an area that auditors must be allowed to evaluate.

I would like to close with this statement. I believe the attitude of the military procurement community toward getting more off the taxpayers' defense dollar can be summarized by two conversations that I had with Col. John Roberts, a former Air Force plant representative at Pratt & Whitney at West Palm Beach. My frustration at the bad stewardship of my DCAA superiors and my Air Force counterparts finally reached the point where I began discussing with my associates the possibility of taking my information to higher levels in the Department of Defense and to the taxpayer directly.

When Colonel Roberts got wind of this, he invited me into his office for a friendly chat. He especially wanted to dissuade me from going public. He summed up his pitch to me, and, I believe, the military procurement community's message to the American public by saying, "It's the system, George. You can't change it."

Mr. DINGELL. Mr. Spanton, you have given the committee most helpful testimony, for which we thank you.

The Chair will recognize members for questions at this time.

You made allusion to certain documents and publications. Would you make them available to us for insertion in the record at the appropriate place?

Mr. SPANTON. Yes.

[Testimony resumes on p. 88.]

[The prepared statement and attachments of Mr. Spanton follow:]

TESTIMONY OF
GEORGE R. SPANTON

Former Resident Auditor of Pratt & Whitney, West Palm Beach

Mr. Chairman, thank you for inviting me to appear before your committee today. I appreciate the opportunity to talk about my experiences as a resident auditor at Pratt & Whitney's government Products Division in West Palm Beach, Florida. I hope they will shed some light on current problems in the Defense Department's acquisition and auditing agencies, problems I feel contribute to a climate that encourages companies like Pratt & Whitney and General Dynamics to try and charge the government for outrageous overhead expenses. The truth is, they are often successful; the result is millions of wasted tax dollars per year.

Several months ago, this committee thought me sufficiently knowledgeable of Defense Department auditing practices that they called me out of retirement to assist them in their investigation of overhead abuse by General Dynamics. Once again, I am most happy to be of service to you.

Just to give you some background on my credentials, I retired from the Defense Contract Audit Agency in December 1983. I was with the agency since its inception in 1967. My last assignment was as the audit manager at Pratt & Whitney where I supervised up to 25 auditors who reviewed the proposed and incurred costs to the government not only for Pratt & Whitney, but for over one hundred companies in southern Florida and overseas. However, the bulk of our work, approximately 75%, was directed at reviewing Pratt & Whitney's billings to the government. In all, I have 33 years of government service, including five years of military service in World War II and 28 years as a supervisor with several military audit agencies.

My most serious clashes with DCAA, the Air Force, and Pratt & Whitney began in 1981 when I and my auditors raised issues concerning travel and entertainment expenses that Pratt & Whitney was billing to the government. Then, in 1982, we questioned excess salary escalations that Pratt & Whitney was proposing for its employees, an issue that neither the Air Force plant representative or my agency were willing to confront. At this time we also began to have more serious problems getting access to the financial records of the company that we felt were essential to performing complete and effective audits. I knew we were in trouble in 1981 when Pratt & Whitney brought in a new controller. His name was Stephen Harvey. He was a former GAO auditor who had been responsible for auditing Pratt & Whitney in East Hartford and then went to work for the company he audited. A remark he made to me indicated that it was going to be much tougher getting the information we needed. Mr. Harvey said, in effect, that while I had gotten a great deal of information from his predecessor, I wouldn't be finding it so easy anymore. Later, I was attempting to get information on executive salary levels that an earlier government review said were 40% higher than those of executives in comparable private sector companies. Mr. Harvey accused me of wanting that information simply to satisfy my own curiosity. Mr. Harvey's attitude made it clear to me that it was going to be a battle to obtain the company records we needed.

TRAVEL AND ENTERTAINMENT EXPENSES

Those access to records problems first manifested themselves in reviews we did of Pratt & Whitney's travel and entertainment expenses in 1981 when we inadvertently obtained invoices that showed that Pratt & Whitney was entertaining military personnel and other government officials, which can be a violation of the law. When we attempted to get additional details about the company's guest list and expenses, we were denied our requests for pertinent records. We wanted to know if government personnel on the guest lists we did see, which included generals, admirals, congressman, Air Force test pilots, and other DoD employees, had reimbursed the contractor for their meals and entertainment. Not to reimburse the contractor could have been a violation of the Anti-Kickback act. We were also concerned about the percentage of the allocation of entertainment costs which Pratt & Whitney were charged to the government by the company since we were unable to determine the validity of the company's percentage calculation.

We submitted the memorandum of our concerns up the chain of command at DCAA. No action was taken for seven months until a Defense Department investigator showed up in my office one day because he had been told to investigate me! The allegation, which was anonymous, was that I was being too soft on the contractor. After several weeks investigation, Mr. John Batson, of the Defense Criminal Investigative Service, determined the allegation had no basis. It was then out of frustration, that I gave him a copy of the travel and entertainment memorandum that I had given to my superiors. Mr. Batson was extremely interested and subsequently was instrumental in generating a Justice Department investigation of the matter. Mr. Cavanaugh, of the FBI, was assigned to the case.

When I called for a DCAA investigation into questionable overhead charges at Pratt & Whitney, I also stated that the same abuses that we found at Pratt & Whitney existed throughout the defense industry. I believed this because of my many years of experience as an audit manager and regional supervisor, dealing first-hand with literally hundreds of contractors. The work I have done for this committee on General Dynamics is additional evidence of the extent of the problem. While I do not recall Pratt & Whitney executives charging the government for boarding pet dogs like Fursten, I do know the following claims of allowable costs were common to both Pratt & Whitney and General Dynamics.

Corporate Aircraft

Both companies charged millions of dollars to the government to maintain fleets of private aircraft for the use of company employees and their guests. It would have been much less expensive to have the employees fly on commercial airlines.

Travel for Spouses

Spouses of executives travel world-wide at government expense.

Washington Office Expenses

Defense contractors keep offices in Washington primarily to serve as a base for their lobbying efforts. I feel these office expenses are inadequately audited. DCAA's auditing effort consisted mainly of sending questionnaires to the contractor personnel in those offices.

Extraneous Expenses

The following is a list of some expenses that both Pratt & Whitney and General Dynamics submitted for reimbursement by the government:

* Banquets, including alcoholic beverages
* Charter boat cruises
* Country club memberships including green fees
* Theatre tickets
* Souvenirs
* Entertainment, including that for government officials
* Military associations

In addition, my staff questioned the following types of expenses claimed by Pratt & Whitney: tuxedo rentals, babysitters, shipping crates for ski clothes, custom duties, firewood, basketball and football tickets, softball league registrations, trophy presentations, travel costs for business guests, and travel to balls, receptions, reunions, picnics, exhibitions, and trade shows.

I do not know if these questioned costs were sustained by the contracting officers who make the final determination.

ACCESS TO RECORDS

I have long expressed to DCAA management, to Congress, and the press my feeling that access to contractors' records is the most important issue for our auditors. Unencumbered access to the records of defense contractors is essential for DCAA to fulfill its mission. Unfortunately, many contractors are successful in imposing limitations to varying degrees.

There is statutory support for access contained in the provisions of 10 USC (2312 (a) and 10 USC 2306 (f) (3). These laws should be sufficient to achieve the required access in defense contractor plants under normal circumstances. However, auditors are conditioned to by-pass access problems rather than confront the issue. They realize that attempts to resolve access problems are risky because the agency would rather see them work around the problem and performance ratings are influenced by the harmony of the contractor/auditor relationship. Very simply, auditors are hesitant to bring these matters to the agency's attention because they are not supported by management.

The agency's views on access were spelled out in a rebuttal they issued to concerns I raised in 1982 that DCAA has compromised its audit missions and principles. Their response reads as follows:

> "Mr. Spanton presents a philosophy regarding access to records which would give the auditor complete, unrestricted, unencumbered, and unlimited access. We are sure that everyone in the DCAA would agree that this would be an ideal situation and would lessen the difficulties encountered in performing some audits. In our view, Mr. Spanton's comments fail to recognize contractual requirements. In addition, his views do not give consideration to contractor prerogatives with respect to proprietary data and mix of workload."

The above statement demonstrates the agency's failure to understand the very basic requirements of their profession. Phrases like "corraborative evidence," "contractual requirements," "contractor prerogatives" and "proprietary rights" are cop outs.

The government's rights to access should be paramount and seeking alternatives to, and compromising on, such vital matters should not be tolerated by our auditors.

The limitations on access imposed by contractors create conditions of impairment which often result in qualified reports that should not have been issued.

I was pleased to find my contentions supported by the findings of the Defense Department Inspector General. In 1984, the IG issued a report saying they found problems of access existed in 13 of 23 offices they surveyed, and that serious problems had existed in three loctions for years. They found that DCAA had the power to withhold payments if the information that is requested is not provided. But the IG found that DCAA almost never uses that power and instead issues reports full of qualifications "that are of limited, if any usefulness." They further stated that auditors who have trouble with individual contractors are rarely backed up by their superiors at DCAA headquarters.

In my recent work for this committee looking into General Dynamics, I found that they too presented a serious access to records problem for auditors in the St. Louis, Fort Worth, and Washington offices of the company.

AIR FORCE COMPLICITY

It is not only the contractors and DCAA management that are to blame for contributing to excessive procurement costs. At any contractor location, the interests of the government are represented by the service's plant representative office. From my experience, I have observed that, too often, the Air Force Plant

Representative sees his role as that of a partner with the contractor. He is concerned with maintaining a harmonious relationship, in getting along with the contractor, rather than challenging him. AFPRO representatives are particularly vulnerable to the revolving door syndrome. Several of the predecessors of the current Pratt & Whitney AFPRO went to work for the company, after retiring from the military, either as full-time employees or consultants.

In my own case, the Air Force's concern for the contractor even extended to attempts to have me removed as resident auditor because of fear that my audits and my discussions of them with the media, would embarrass the Air Force. In 1983, the AFPRO commander, Colonel John Roberts, was investigated by the Air Force Inspector General for attempting to have me removed from my job. While the AF/IG found that Col. Roberts did nothing overt or official to have me transferred or fired, the Defense Department investigator on the case, John Batson, told the AF/IG that Col. Roberts had suggested to him that he, Batson, go to my superior in an effort to have me removed or dismissed. The Air Force staff judge advocate at Pratt & Whitney, Captain Jeffrey Rohm, told the AF/IG that he had often heard the Colonel privately express the wish that I be removed. Indeed, another of my superiors, Alvin Tueller told the AF/IG that Col. Roberts also expressed his opinion to him that I be removed. According to Mr. Tueller, Col. Roberts even volunteered to put his opinions in writing to DCAA managers.

Also revealing was the response of Col. Roberts to a question about the release of a very controversial report my office had issued on the high salary increases granted to contractor employees. Col. Roberts was very upset that the report might be leaked to the press. The suspicion was that I would be the source of that leak. Col. Roberts stated:

> "I don't want to do anything that will embarrass the Air Force, and don't take that as that somebody's going to cover something up to keep from embarrassing the Air Force, but I think we have an obligation today to the American public to, not to embarrass the Department of Defense because that has a major impact on the budget that we get, some of these things. So, in that context, yes I didn't want something that needed further review or further refinement or further work to go out and be used against us."

I think Col. Roberts' statement makes it clear that the priorities of the Air Force are to protect its image, and, more importantly, the flow of money. It is not whether the Air Force is getting the best product at the best price, but whether or not the budget can be increased that drives the procurement process. I was in trouble with DCAA and the Air Force because our philosophies simply did not match. In the current climate, those who want to save money are punished, those who spend it are rewarded.

COMPENSATION

In addition to my audits on travel and entertainment expenses, I issued a controversial audit on rapidly spiraling labor costs. My March 1982 report showed that the raises for the company's employees were twice as high as those granted workers in the private sector, triple that of government employees. The report was based on the assumption that the Department of Defense should hold their contractors to the same limitations that prevail in the competitive environment of private industry. We estimated that Pratt & Whitney's proposed raise would cost the government an unnecessary $150 million between 1982 and 1985.

Coincidentally, the Secretary of the Air Force issued his own directive that contractor labor costs were excessive and should be controlled. I have submitted (Attachment A) a follow-up letter from Lt. Colonel Charles H. MacNevin to DCAA Director Charles Starrett dated August 17, 1982 which says:

> "We have been concerned for some time that we in the Air Force have not been careful enough about controlling the increased costs associated with wage settlements which our contractors make with their labor forces. There has recently been a great deal of talk about holding down cost of living increases for Air Force personnel, both military and civilian, and in entitlement programs. We believe it is improper to try and hold these sorts of increases down while we pay substantially larger wage increases to those labor forces which build our weapons systems."

I was delighted to see the Air Force Secretary recognized the seriousness of the problem. However, the savings that could result by seriously addressing these ever increasing compensation rates have not yet been realized.

My office also addressed itself to salaries and other compensation enjoyed by Pratt & Whitney executives. We were blocked in our attempts to review the detailed support documents for these salaries which were 40% higher than those earned by executives in comparable industries in the private sector. Finally in the summer 1983, we withheld $28 million in payments to the contractor to enforce our right of access. The data was finally released and an audit was initiated to ascertain the excessive costs these salaries represented. However, it was not completed upon my departure and it is my understanding that the audit was cancelled. Meanwhile, both the Congressional Budget Office and the General Accounting Office have independently reported that salaries among defense aerospace corporations are signficantly higher than those paid in the private sector.

I would like now to discuss some additional areas of concern that I have never touched on publically. I introduce them in the hope that they may be considered for future investigation.

DOUBLE CHARGING

In 1981 and 1982, Pratt & Whitney charged the government over $1 million each year for Washington costs associated only with its Government Products Division. I am not aware of how much of the money claimed by the contractor was considered allowable by the DCAA.

In 1983, my staff found evidence that Pratt & Whitney double charged the government. It charged twice for its Washington office costs, that is, it twice claimed reimbursement of its $920,000 office expenses. We also found that over a period of several years, the company duplicated $2.9 million in various general and administrative (G & A) expenses. That $2.9 million did include some Washington office costs. Because of the circumstances surrounding these double billings and the contractor's unsatisfactory response to our inquiries, I referred the matter to DCAA headquarters as suspected irregular conduct and requested an investigation by an outside agency. The DCAA, in transmitting my request for an investigation, deleted a substantial portion of my report. Instead, they substituted a modified version over my signature. I have no explanation as to why they doctored my report, but I am still troubled by it. I do not know that if their action in any way influenced a decision to look into the situation by an investigatory agency to see if there was an intent to defraud the government.

What I do know is that the doublecharging was acknowledged by the company and the money was repaid. However, Pratt & Whitney tried to make it appear as if they, and not my staff, had uncovered the abuse. I would be happy to furnish documents about my allegations to the committee at your request.

PROFITS

Recently, the New York Times reported that the average profit on equity enjoyed by the country's top ten defense contractors was 25.6%, a much higher rate than that earned by most companies in the private sector. This is another area of potential abuse, yet DCAA auditors are discouraged from questioning contractors' profits. I have included as Attachment B a 1982 DCAA memo in response to a request for guidance on contractor profit. That response cited agency regulations to the effect that unless such information is requested by the contracting officer "the auditor will not attempt to do anything further in the profit area." I feel this is an area that auditors must be allowed to evaluate.

AGENCY REVIEWS OF DCAA

From time to time, other governmental investigatory agencies such as the General Accounting Office and the Inspector General attempt to review the work of the DCAA. Unfortunately, DCAA management often behaves as badly as the defense contractors the agency is suppose to monitor. They attempt to restrict the access of those investigatory agencies to DCAA records and facts pertinent to their reviews.

For instance, Attachment C is a 1983 memo from DCAA headquarters to its field audit FAO managers urging them to "exercise caution" in answering GAO's questions about the propriety of the way contracting officers resolve the recommendations of DCAA auditors.

In addition, the Baltimore Sun (3/1/84) reported that the Inspector General had complained in the summer of 1983 that an agreement between the Inspector General and then DOD Comptroller Vincent Puritano to provide access to data, was being ignored by the DCAA. The IG said that DCAA "had delayed reviews, withheld information, attempted to control the scope of the investigation and ignored agreements for access to files... DCAA appears to consider our review a game in which they see how much can be kept from us by providing the bare minimum of data and then only if we persist in asking for it."

How can we believe the claims by DCAA management that they encourage aggressive attempts to access information from contractors when this is the example they set?

I believe the attitude of the military procurement community toward getting more for the taxpayers' defense dollar can be summarized by two conversations I had with Col. John Roberts, the former Air Force Plant Representative at Pratt & Whitney in West Palm Beach. My frustration at the bad stewardship of my DCAA superiors and my Air Force counterparts finally reached the point where I began discussing with my associates the possibility of taking my information to higher levels in the Department of Defense and to the taxpayer directly. When Col. Roberts got wind of this, he invited me into his office for a friendly chat. He especially wanted to dissuade me from going public. He summed up his pitch to me, and, I believe, the military procurement community's message to the American public, by saying, "It's the system, George. You can't change it."

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330

OFFICE OF THE SECRETARY

August 17, 1982

Mr. Charles O. Starrett, Jr.
Director
Defense Contract Audit Agency
Cameron Station
Alexandria, Virginia 22314

ATTACHMENT A

Dear Mr. Starrett:

We have been concerned for some time that we in the Air Force have not been careful enough about controlling the increased costs associated with wage settlements which our contractors make with their labor forces. There has recently been a great deal of talk about holding down cost-of-living increases for Air Force personnel, both military and civilian, and in entitlement programs. We believe it is improper to try to hold these sorts of increases down while we pay substantially larger wage increases to those labor forces which build our weapon systems.

This past April, the Secretary sent a memorandum to his Assistant Secretary for Financial Management, asking him to ensure that we do not pay negotiated wage settlements to our weapons producers which are greater than the amounts which the Federal Government decides are adequate for its own employees and recipients.

As you might imagine, it was with keen interest that we learned that your agency has been actively studying this same issue. I am advised of two reports you have issued which the Secretary would be most interested in receiving:

a. Audit Report on Evaluation of Proposed 1982 - 1984 Forward Pricing Direct Labor Rates, United Technologies Corporation, 13 March 1982, DCAA Report No. 1481-2A230006.

b. Audit Report on Evaluation of Proposed 1982-1984 Forward Pricing Direct Labor Rates, United Technologies Corporation, 15 April 1982, Report No. 1481-2A230006-S1.

I understand that these reports were written by your Resident Auditor at the Pratt and Whitney plant in West Palm Beach, Florida. Since there may be additional reports or memoranda on this subject since April, I would appreciate it if you would forward these also.

Sincerely,

SAF/c

Charles H. MacNevin
Lt Colonel, USAF
Deputy Military Assistant

202-697-8141

Inter-Office Memorandum

22 October 1982

TO RAM ATTACHMENT B

FROM RSPM

SUBJECT: Request for Guidance Relative to Comments on Profit

In response to your verbal request, we reviewed the attached "Comments on Profit" and offer the following suggestions.

A literal interpretation of Agency guidance contained in CAM 5-700 would conclude that such comments are not appropriate. That is, the guidance does not provide for comparisons of total profit in terms of rates of return on facilities investment, and CAM 5-702(e) states, "Except for information called for above, which is intended to help the purchasing contracting officer by furnishing him with information which he will usually wish to consider, the auditor will not attempt to do anything further in the profit area except upon specific request by the purchasing contracting officer." We discussed this matter with Maurice Nestor, PAD, who in turn coordinated the issue with other PAD program managers. Mr. Nestor advised that CAM 5-702(e) was not intended to prohibit our furnishing useful information to PCOs. He further advised that the type of information under consideration (total profit comparisons based on return on facilities investment) may be useful if presented in a manner which would place it in proper perspetive.

We believe that profit comparisons based solely on rates of return on capital investment and labeling differences between contract rates and corporate-wide rates as "abnormal" may be misleading when other pertinent information is not provided. Accordingly, we offer the following recommendations:

a. As you know, facilities capital employed is only one of a number of factors affecting negotiated profit. We suggest that audit guidance contained in CAM 5-700 be followed by furnishing appropriate comments relative to other significant factors (i.e., cost risk, contractor effort, special factors, etc.) along with return on capital comparisons.

b. Differences developed relative to return on capital comparisons should not be identified as "abnormal profit" since such a conclusion cannot be reached by considering only one of the factors affecting profit.

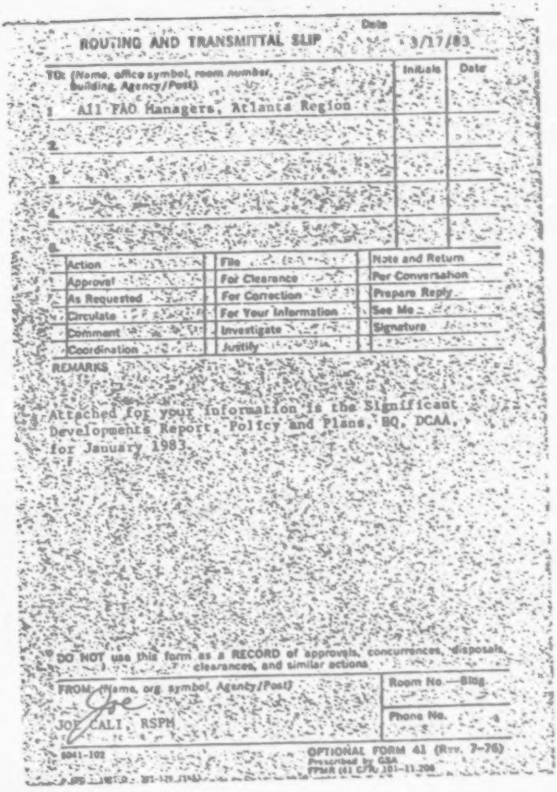
c. The calculations could be affected by the types of assets included or excluded from the net asset values being compared. For example, land held for speculation or expansion and idle facilities must be excluded from facilities capital employed cost of money calculations for a contract while such amounts would be included in total corporate amounts. Adjustments should be made for any significant differences and/or results should be appropriately qualified.

d. The comparison constructively inclues actual interest paid in corporatewide profit while contract profit includes imputed cost of money. This difference should be clearly disclosed in the audit report.

In summary, auditors should be encouraged to continue to develop innovative analytical techniques to provide useful information to our acquisition clients. But, of course, we have a professional responsibility to provide such information in proper context to ensure that the users of our reports will not be misled.

Joe Cali
JOE CALI
Regional Special Programs Manager

Enclosure



ROUTING AND TRANSMITTAL SLIP

Date 3/17/83

TO: (Name, office symbol, room number, building, Agency/Post)	Initials	Date
1 All FAO Managers, Atlanta Region		
2.		
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☐	Action	☐	File	☐	Note and Return
☐	Approval	☐	For Clearance	☐	Per Conversation
☐	As Requested	☐	For Correction	☐	Prepare Reply
☐	Circulate	☐	For Your Information	☐	See Me
☐	Comment	☐	Investigate	☐	Signature
☐	Coordination	☐	Justify	☐	

REMARKS

Attached for your information is the Significant Developments Report, Policy and Plans, HQ, DCAA, for January 1983.

DO NOT use this form as a RECORD of approvals, concurrences, disposals, clearances, and similar actions

FROM: (Name, org. symbol, Agency/Post)	Room No.—Bldg.
Joe JOE CALI, RSPM	Phone No.

5041-102

OPTIONAL FORM 41 (Rev. 7-76)
Prescribed by GSA
FPMR (41 CFR) 101-11.206

ATTACHMENT C

MAR 2 1 1983

SIGNIFICANT DEVELOPMENTS REPORT
POLICY LIAISON DIVISION
JANUARY 1983

GAO ACTIVITIES (Neil)

Notified regional directors of a GAO review of "Contracting Officers' Use of Defense Contract Audit Agency Reports." This review is another phase of GAO's overall review of DCAA. Regions were advised that FAO managers should exercise caution in responding to GAO questions regarding the propriety of contracting officer resolution of audit report recommendations since any such qualitative determinations by DCAA personnel could be considered a noncompliance with DoD Instruction 7600.3, "Internal Audit in the Department of Defense." (GAO Code 942194)

Met with GAO representatives regarding GAO's survey of the allowability and allocability of home office expenses incurred in connection with the Foreign Corrupt Practices Act. Discussed GAO's general conclusions reached to date and their plans for the balance of the review. As of now, GAO has tentatively identified three "findings", (1) DoD procurement should have issued guidance covering the unallowability of such costs, (2) DCAA should have used CAS 403 as an additional basis for taking exception to claimed special investigative costs, and (3) DoD should re-open those negotiations, when contractually possible, where such costs were accepted. Coordination with GAO is continuing.

Notified regional directors of planned GAO review of "Effectiveness of the Cost Estimating Procedures of the DoD for Major Weapon Systems" (GAO Code 951740).

Distributed to regional directors a listing of GAO assignments scheduled to begin during the quarter beginning 1 January 1983.

AUDIT FOLLOWUP

Prepared MFRD transmitting DoDD 7640.2, "Policy for Followup on Contract Audit Reports." Regions were advised that coordination with procurement components was underway and, until specific procedures were worked out for implementing the Directive, field auditors should continue to follow the procedures set forth in Headquarters memorandum PLD-114 dated 9 November 1982. (Neil)

Prepared a summary analysis of the new DoDD 7640.2 on contract audit followup for P. (Crichley)

BEST COPY AVAILABLE

Mr. DINGELL. I am particularly interested in the two versions of the statement that you alluded to in your comments with regard to reports to your superiors. Were the changes in that particular document made with your approval, or were they made without your approval?

Mr. SPANTON. I was unaware of the changes in our submission to our headquarters until I believe it was an Air Force investigator showed up with the revised version.

Mr. DINGELL. An Air Force investigator showed up with a revised version?

Mr. SPANTON. I think he was an IG investigator, and this was toward the latter days of my career. He said he was looking into it. I saw the documents he had, and I said, "That's not the version we sent in." He didn't seem to be disturbed about the differences. I gave him a copy of our original document, and I heard nothing more concerning the investigation. I knew he was there for a day or two.

After I retired, an investigator from the same office visited with me in my home concerning another defense contractor in south Florida upon which I had some information. They were trying to get some clarification, and it was then that I asked him the status of the double-charging investigation, and he said it was still under consideration.

Mr. DINGELL. Do you know what happened to that matter?

Mr. SPANTON. As far as I'm concerned, it is still under investigation.

Mr. DINGELL. How long this inquiry has been going on?

Mr. SPANTON. A year and a half. That's not unusual, because I am aware of several other investigations that I had requested, apart from the Pratt & Whitney investigation, involving travel and entertainment. That was turned in to my agency and I never received further word as to what happened, what decision was made.

For example, I am aware of one—and these are significant areas. I recall one that involved a major supplier of computer parts for the Department of Defense who had issued a catalog. According to procurement regulations, these parts could only be listed in the catalog as commercial items if they were truly commercial.

Several of our audits disclosed that for the most part their customers were not commercial, but they were first, second and third-tier military suppliers. Despite our bringing this to their attention on several occasions, they continued to price these parts out as though they were commercial.

We felt that this was a condition that could exist throughout the Nation, and under those circumstances, with big dollars involved, we recommended an investigation. I never heard a word about what happened to our request.

Mr. DINGELL. We appreciate any documents that you might have in your possession relative to this.

The Chair is going to recognize my colleagues in accordance with the rule. The Chair recognizes first the gentleman from Oregon.

Mr. WYDEN. Thank you, Mr. Chairman, and Mr. Spanton.

I think you have done a great service to the country. You have essentially portrayed a whole number of the loopholes in the system that seems to have more holes than a piece of Swiss cheese, and I commend you for it, and I just want to ask you a couple of questions from the standpoint of your testimony.

At one point you talked about Colonel Roberts stating that his principal concern was to keep from embarrassing the Air Force, and you talk about his statement saying we have an obligation today to the American public not to embarrass the Department of Defense, because that has a major impact on the budget that we get, and it goes on to talk about how that could be used against Colonel Roberts, I gather, in terms of getting more money in the budget.

That's an incredible statement. I mean that is one of the most amazing things I have heard here, because it says the principal goal of Mr. Roberts and, I gather, some others and I'm going to ask you about this, is not to have a strong cost-effective national defense, but to get as much money as possible.

Did you find that kind of attitude pervasive among people that you dealt with in your tenure?

Mr. SPANTON. That is certainly the rule. The rule within the Department of Defense is to procure and essentially to—and I'm not saying this is true of every individual, but the general rule is to procure without consideration of costs.

Also the rule is to spend everything you have so that you can protect your next budget with its planned increases. So they are not concerned about protecting the dollar as much as acquiring the defense materials.

Mr. WYDEN. And in the time that you were there, you saw no evidence that there was any effort to change this? I mean presumably what is in the interest of the American people is to reward those who produce some savings. And what you are telling us is just the opposite, that those who try to save money for the taxpayer are punished, and as of now there are no changes in place to turn this around.

Mr. SPANTON. No, there are no changes. Changes, as I said earlier, are simple to make; really, they are truly simple. They are organizational changes on a large scale at a high level. But the procurement philosophy is to buy.

Now, for example, I can relate a conversation where as auditors we had close liaison. The auditors don't just work with books and records; they look at the operation, the effectiveness and efficiency of performance. On a major proposal I had a meeting with several members of my staff and the staff of Air Force engineers working in the AFPRO office, the Air Force Plant Representative office, to examine the million or so engineering hours being proposed by the contractor for a new contract. And we asked them to make an assessment of reasonableness of these million hours.

The response was whatever the contractor asks for must be reasonable. He knows his job better than we do. So there was no consideration given to whether it should be half a million or a million. If the contractor said $2 million, he would get the $2 million.

Mr. WYDEN. The contractor essentially wrote the contract, conducted the negotiations and told the Government how much they were going to get?

Mr. SPANTON. Generally that's the way it operates, yes, sir.

Now recently—I would say this was in 1983—it was ascertained that Pratt & Whitney had requested a review by a consulting firm of their engineering operations. This was performed by, I believe, Booz, Allen & Hamilton, and the results of their review and their review was charged into government contracts, was that Pratt & Whitney's staffing was double what they needed to perform under their contracts. Double. And we raised the issue that even though they had this information, we stumbled upon it. At least it was uncovered.

There were no steps made by the contractor to inform procurement that reductions were in order and would take place. Now I would say virtually every audit operation in the Department of Defense throughout the United States can go through defense contractor plants and if they perform floor checks, which are observations, really, of the performance of the employees, they find idleness. It is more often the rule than the exception.

Now I'm not talking about the low level people. I'm not talking about the people running the machine shops, the assembly. I'm talking the mid and upper levels. And that's where the big dollars are.

But there are absolutely no limitations, no controls on these costs.

Now entertainment, there are millions of dollars abuse in entertainment and other sundry type expenses. But there are billions of dollars in wasted labor, in the excesses of these executive salaries.

As I said earlier, rules can be promulgated, but the Defense Contract Auditing Agency has no rules.

Mr. **Wyden**. Let me ask you one more question. You made a statement on page 6 that I think goes right to the heart of the problem. Apparently you were very much involved in these efforts and DCAA was concerned about the way you did your job, and on page 6 of your testimony you quote here, they apparently wrote you:

> Mr. Spanton presents a philosophy regarding access to records which would give the auditor complete, unrestricted, unencumbered and unlimited access. We are sure that everyone in the DCAA would agree that this would be an ideal situation and would lessen the difficulties encountered in performing some audits. In our view, Mr. Spanton's comments fail to recognize contractual requirements.

Now I may not be reading this right, but is it actually built into these contracts that the Government wouldn't be getting complete and unrestricted access? What in the world could that possibly mean when they say that your comments failed to recognize contractual requirements?

Mr. **Spanton**. I don't understand it, either. But this is a written statement by the DCAA in response to my complaints that the DCAA had compromised its responsibility. And I had submitted a written statement to them in which I said complete, unencumbered access to these records is necessary for an auditor to do his job, plain and simple, right to the point. All the contracts require it. And I am at a loss as to the meaning of that paragraph, other than it shows implicitly the philosophy of the agency, that if they can't get records, they will do without them.

Mr. **Wyden**. Well, it, in my view, is an indictment of the entire system, because presumably that's what we want at a time when the taxpayers are being bilked out of millions and millions of dollars. It's the opportunity to get into these records and see them in a complete and comprehensive way.

And to tell you the truth, that statement sheds a great deal of light, for example, on something I said at the beginning. We, with a handful of investigators on the subcommittee, came up with things that 3,400 auditors at DCAA couldn't come up with.

Mr. SPANTON. Yes, sir. In fact, the Washington office got virtually no audit over the years by the DCAA because they weren't permitted to do these audits, and it was a condition again known by the DCAA and it existed throughout the defense acquisition community, the defense contract organizations.

Mr. WYDEN. One last question that I had. You talked on page 10 with respect to that issue of the salaries of Pratt & Whitney executives being 40 percent higher than those earned by executives in comparable industries in the private sector. And apparently there was an audit that was initiated in this area to ascertain the excessive costs that the salaries represented, and you state in here that it was not completed and that the audit was cancelled.

Do you know who cancelled the audit?

Mr. SPANTON. Well, I must presume that the individual that replaced me didn't pursue the audit.

Mr. WYDEN. Who was that?

Mr. SPANTON. I don't recall his name, but it was the manager that took over my office when I retired at the end of 1983.

Mr. WYDEN. But you felt it was in the public interest certainly to pursue that?

Mr. SPANTON. Oh, certainly. We are talking again about millions of dollars. The auditor has got a broad responsibility, and in a case of executive salaries he has to make some kind of determination. He cannot permit unlimited executive salaries.

He's got to make some determination as to what he considers reasonable to perform under the terms of the contract. Otherwise, as I have observed over the years, every time a defense budget jumps, the executives get a pay raise, significant pay raises. And there have to be parameters.

We talked about these escalations of labor costs. There have to be some reasonable limitations where if the contractor wants to pay more to its executives, let them pay these increased salaries out of profits, so they can perform better.

But it just seems strange that the President gets a couple hundred thousand dollars a year and the man that heads up a medium-sized plant pulls down $600,000 or $800,000.

I think we had 100 mid-level executives where the average salaries were over $100,000 of small plants. There are no limitations, no controls. Whatever funds they have, they will expend on the theory profits will be based on costs, and the more they spend, the greater the profits.

Mr. WYDEN. I want to let my colleagues have plenty of time for their questions. The only thing that I would say to you, Mr. Spanton, is I think we need a strong national defense in this country, but it has become pretty clear to me that we also need to defend the taxpayers from these grotesque billings. You have helped bring some of these very shoddy practices to light, and I think that is going to speed up our getting the reforms we need.

We thank you for it.

Mr. **Spanton**. Let me just say on that point, I believe in a strong defense, too, and I believe that the way you are going to get a strong defense is to cut out the waste. If you need that many dollars for defense, then get weapons for it and not waste.

Mr. **Wyden**. Well, unfortunately, there are a lot of auditors and others at the Pentagon who seem to be cheering for the status quo, and that is going to make our job that much tougher. But I think this is the Congress, where we finally see these reforms enacted, and I congratulate you on your good work.

Mr. **Spanton**. Thank you.

Mr. **Bryant** [presiding]. The gentleman's time has expired.

The Chair recognizes the gentleman from North Carolina.

Mr. **Broyhill**. Thank you. And I do appreciate your appearing today. I sure wish we had had a little time this morning to talk with you and be able to delve into some of these questions, because obviously you do have tremendous knowlege and experience in this area and can help us and lead us to some of the answers I think we need.

And to follow up on the questions that were being asked by the gentleman from Oregon, I am not quite sure I understand, is your last statement that you are not alleging that in the case of Pratt & Whitney, that their executive pay was excessive? You are indicating that all of—are you stating that the DCAA regs are not specific enough? Is that what you are saying? Or are you saying that they were violating DCAA regs? That's what I'm not sure of.

Mr. **Spanton**. No, I am saying that the DCAA regulations establish a requirement that the auditors have to examine all costs to make determinations, if they are not specifically unallowable, of what is reasonable. And the DCAA, to the best of my knowledge, has stayed away entirely from the subject of the reasonableness of salaries.

So we did make a review.

Mr. **Broyhill**. OK. So there are not sufficient DCAA regs governing executive pay? That's what you are testifying to?

Mr. **Spanton**. Yes. Well, I am suggesting that there should be parameters established as to what would be reasonable to pay executives and so that consistency can also be established between the different contractor operations.

We did say at Pratt & Whitney we considered 45 percent of the executive salaries to be unreasonable and that was based upon the determination by the contract audit management office out of Atlanta in making a survey of surrounding industry in the south Florida area, they found that private industry salaries were 40 to 45 percent less at the executive level than what was being paid at Pratt & Whitney.

And so prior to my departure we were getting the records. First, the contractor refused to release the records of his executive salaries. In fact, I was told by one of the officials that the only reason we got it was because we were nosy. That same official told me that he was an ex-GAO auditor, and when I asked him why he went to work or left the Government, he said, "How else can I get into six figures?"

Mr. **Broyhill**. If we asked DCAA what their response is with respect to regulations, specific regulations governing the allowable costs of executive pay, what are they likely to tell us, and what would be your response to it?

Mr. **Spanton**. They are likely to say that the responsibility of the field auditor is to make a determination of reasonableness as compared to what other industries pay their executives in like circumstances.

Of course, none of the data is available or provided to these auditors who work for the most part on very tight deadlines to have this information. So the expedience on the part of the auditors is to ignore it.

Mr. **Broyhill**. Mr. Spanton, since this article that was in the local paper the other day did stir up a lot of comment, I would like to ask you about two or three of these items, because we should find out what the situation is with respect to these. And, of course, really what you are telling us, as I understand it, we ought to really look at the DCAA policies and regulations. That's really what you're saying. But with respect to P&W, to your knowledge, are a number of these alleged overcharges, are they still unpaid by DOD? That is, are they still under discussion, or are they still under investigation?

Mr. **Spanton**. I think the saddest of many of the items that you are reading about is on hold because of this subject investigation.

Mr. **Broyhill**. For example, on this donation that was cited this morning to the Oklahoma Arts Center, was that permitted as an allowable cost, or was this charged to the Government contract, or was it charged to the corporate side of UT?

Mr. **Spanton**. It was charged into the accounts of the claims against Government contracts.

Mr. **Broyhill**. That is to your knowledge?

Mr. **Spanton**. Yes.

Mr. **Broyhill**. What about the leasing costs? Have executive car allowances been permitted in other Government contracts? Is this permitted under DCAA regulations?

Mr. **Spanton**. Again, the auditor has to work with the determinations of reasonableness, because the regulations as stated earlier, are written so that on limitations or control of costs, every one of these regulations has an out, leaves the door open just a little bit. And these contractors are using that open door.

So, the auditor has responsibility.

In this particular case, the contractor's policy on the leased cars, that if an employee in the performance of his duties, requires a leased car because he would be travelling in excess of 24,000 miles per year, then he would be permitted to have one. This leasing of 80 or so vehicles by the executives, is the total abuse, and we questioned it on that basis.

Mr. **Broyhill**. Well, you know this whole issue of expense of autos, has been a big issue up here for everybody. We have had this issue of maintaining contemporaneous records of automobiles. And, of course, we do know that businesses all over the country do not only reimburse employees and executives for use of cars, but also utilize executive cars, and you might say compensation.

I wondered if in your experience, is this a common practice by defense contractors, and whether or not this is an allowable expense under DCAA rules? In other words, in this case that was in the paper, was P&W—were they operating under the rules, or are you telling us that DCAA regulations here again as you testified a few moments ago, perhaps are vague and not precise, and should be tightened up?

Mr. SPANTON. That's right. There are no rules. There is a rule of reasonableness.

It was presumed when the regulations were written years back, that a contractor should know what is reasonable to be incurred in performing his business, in carrying out his business. And you reach a point where it is clearly unreasonable without any laws.

There are certain costs where any effective management could make a determination that these costs were unreasonable, and this other group of costs is reasonable. And, there might be a group in the middle where they could go either way.

But, the expenses of leased cars, where the individuals in some cases put them up on blocks for a year or so to save them, so to speak, and then purchased them, and then turn around and get another car, that is totally unreasonable as a business practice.

It should not have been claimed. And if it is claimed, and the auditors do find these costs, they should question it.

However, there is every likelihood that you could go into another DCAA office and find that they allowed like type costs.

Mr. BROYHILL. Well, there is another section of this article which refers to rebates on certain consumer products that are made by another company under UT and apparently they were offered to employees as employee compensation.

To your knowledge, were these charged to the Government, and were they OK'd under DCAA rules?

Mr. SPANTON. Yes. These costs were charged to the Government. We inquired of DCAA headquarters, and they told us that we should accept them because other offices do accept them.

Mr. BROYHILL. You were told by your superiors that they should be accepted?

Mr. SPANTON. That's right. They said they researched other offices—they claim again that it is a practice and they are accepting it.

We consider it totally unacceptable for many reasons. One being it gives a competitive edge over those companies that are not involved in defense work.

Mr. BROYHILL. The chairman referred today to a check that was written to the Breakers Hotel for a party.

Do you know what type of party that was? What kind of entertainment?

Did you investigate that?

Mr. SPANTON. I remember the comment. There were many parties, so I don't know which one in particular. But, parties were charged to contracts.

You might have an example of one that was not. But, if you show me the documents I can tell you very quickly.

Mr. Broyhill. Well, I'm not sure. They may have it somewhere here, the check. But it seems to me I was told, or saw somewhere that this was a party that was sponsored for an oldtimers' club or something of that sort.

Now, my question is, is this type of expense for employees, $33,288, is that type of an expense for an oldtimers' club or whatever, is that allowable under DCAA rules and regulations as an employee benefit?

Mr. Spanton. I would say in my determination, because we have to make these determinations, that we consider it unnecessary and unallowable. That is not to say that some other office in some other part of Florida or other part of the country would not accept it as allowable.

Again, the vagueness in the regulations gives the contractor the latitude to throw all these costs in and see how much of these costs he can finally recover.

Mr. Broyhill. One other question. With respect to entertainment, we have been told by some that the entertainment expenses for other than the employee were not charged to the Government. But, to your knowledge, were the entertainments, such as the country club dues and so forth, were these charged to the Government, or was that within your audit credo?

Mr. Spanton. Oh, yes. Without looking at the particular document, I can say that——

Mr. Broyhill. I don't have it, but it is in the paper.

Mr. Spanton. I could say that these types of expenses were claimed.

Mr. Wyden. Would the gentleman yield just very briefly?

Mr. Broyhill. Yes.

Mr. Wyden. I might have been confused on that point. You said because there are differing standards in differing offices.

Is it possible if a contractor doesn't get reimbursed in one DCAA office, to go to another and then get reimbursed there?

Mr. Spanton. No. But it could work the other way around.

Mr. Wyden. Explain that.

Mr. Spanton. The DCAA auditor in charge could question these costs as being unacceptable, and then leave that office and a new manager could come in and say, I see nothing wrong with it, accept it.

Mr. Broyhill. I think what the man is telling us, and what I am trying to get at is that perhaps the DCAA rules are not precise, and that they are sometimes vague.

I am putting words in your mouth. I don't want to say that. You are the expert witness here. And, a great deal of latitude is left up to the individual auditors, that flexibility. Is that what you are saying?

Mr. Spanton. Yes. And I think that is being done with intent, because when the final action takes place, it is my opinion that these rules and regulations are written so that the negotiating parties—in this case the procurement office—will have the latitude to reinstate these costs to the contractors, which they generally do.

I had made a recommendation—for example, there were so many abuses in travel, the rates being paid to these hotels and motels and the charges for meals, again, were beyond what anybody would consider reasonable if it was coming out of his own pocket. However, this is coming out of the taxpayers' pocket, so anything goes.

I mean, you could have a defense contractor representative, let's say, visiting Washington. And when he comes back to West Palm Beach, perhaps his expenses were $200 a day. But, the Government representative visiting Washington goes back and he was reimbursed $75 a day. And, both of these payments, one to the defense contractor and one to the Government employee, come out of the same taxpayers' pockets. It just doesn't make sense. We recommended that certainly the Government does a great deal of research in trying to determine what is reasonable for travel allowances for Government employees. And certainly that rule could be followed for these quasi-Government employees in the form of defense contractor personnel.

Why not have them stay within the same limitations? That would cut out a great deal of this expense, a great deal of this entertainment.

It was rejected by the agency saying, this can't be done.

So you do have a situation, for example when we looked at General Dynamics, I found that the auditor in St. Louis used the rule that I am suggesting as a guide, what the Government limitations were, should be followed by the contractor. If you go to another plant, for example in Groton, and they go in another direction. And they allow whatever the contractor incurs, essentially.

Mr. Broyhill. Thank you very much.

Mr. Dingell. The Chair thanks the gentleman.

The Chair recognizes the gentleman from Texas, Mr. Bryant.

Mr. Bryant. Mr. Spanton, I would also like to thank you for your willingness to come forward on behalf of the American people.

You mentioned in your testimony that when you first raised issues concerning travel and entertainment expenses at Pratt & Whitney, your most serious clashes had begun, and that you knew you were in for trouble when Pratt & Whitney brought in a new comptroller, whose name was Mr. Steven Harvey, I think.

You testified that he was a former GAO auditor who had been responsible for auditing at Pratt & Whitney prior to going to work for Pratt & Whitney?

Mr. Spanton. Yes, sir.

Mr. Bryant. Also, you mentioned that AFPRO representatives are particularly vulnerable to the revolving door syndrome. You said that several predecessors of the current Pratt & Whitney AFPRO went to work for the company after retiring from the military either as full-time employees or as consultants.

Speaking of the DCAA as well as the AFPRO, I would be interested to hear what your impression has been at the end of a career in this kind of business, of the extent to which the revolving door syndrome exists in defense contracting?

Mr. Spanton. The revolving door syndrome exists for both the military and on a larger scale, civilians throughout the Department of Defense. It is there. And, who can say to what extent it influences decisions of the Government representatives.

Let's say the AFPRO, Air Force Plant Representative who is assigned to represent the Government, has dealings with the contractor knowing that three years down the road he is going to be retired and looking for a job. And so, when the auditor has all these findings, and they are being reinstated by the procurement office, sure the auditor can jump to a conclusion that this wouldn't be happening if the AFPRO took the same tough approach as the auditor took and was not looking for a job upon his retirement.

It is not just limited to the military. As I said, a GAO man took advantage of the situation and went to work for the contractor.

Many of the DCAA top-level people go to work for contractors or organizations representing contractors. It is common practice.

Again, without oversimplifying it, I think the solutions are there. They are relatively simple. It is just that I guess the actions have to be taken to correct these situations.

For example, when a colonel—and I don't know the levels of salary that a colonel earns—but if a colonel retired and went to work for some defense contractor, then why shouldn't a limitation be placed on a colonel going to work for the defense contractor, just as some colonel that might retire can go to work for, let's say, your committee where there is a ceiling on how much the Government will pay an individual. For example, if the colonel got $30,000 a year on retirement and a civilian with the same level of a colonel's grade would make $65,000 working for the Government, then the maximum he can make in the Government is $35,000.

So, perhaps there ought to be limitations. If he wants to go to work for a defense contractor, fine. But, all the Government will recognize is $35,000.

Why permit him to go, again a quasi-Government employee, go to work for a defense contractor and start out with $75,000?

Mr. Bryant. Who sets the mood or the ethic that informally pervades the ranks of the DCAA in your assessment?

I mean, when you went to work there, from what source did you begin picking up in general what value system sort of rules of the way people thought?

Mr. Spanton. In DCAA?

Mr. Bryant. Yes.

Mr. Spanton. The rule generally in DCAA as it exists throughout these agencies, and Department of Defense, is essentially, number one, you have to be a team player.

Second, if you are going to rock the boat, do it gently and know when to back off.

Those are the rules. And, if you don't know the rules, they make it known to you very quickly. And, if you are an outsider—for example, I was present when individuals were considered for promotion. And, the officials considering these individual auditors for promotion inquired as to how well they got along with the contractor.

And the response was, well, he is a *troublemaker*, he has had difficulties with the contractor.

Well, let's not consider him.

And, he is bypassed.

It doesn't take long for the auditors to get the message; if they want to move ahead, then just do enough to earn your paycheck.

In fact, the auditors want to do a job. They want to be given the opportunity to go forth. They are professionals, and they want to carry out their responsibility. But they also know that they are going to be protected in doing what they get paid to do. And, unfortunately, the protection is not there.

Mr. BRYANT. You also testified that in 1983 your staff found evidence that Pratt & Whitney doublecharged the Government. You may have made reference to that a few moments ago.

Then you stated that the DCAA in transmitting your request for an investigation, deleted a substantial portion of your report and substituted a modified version over your signature.

Has that happened before?

Does that happen often?

What is the effect of it happening this time?

Mr. SPANTON. Well, in some instances, as I stated, we made other recommendations of investigation, and we never heard of them again. So, we don't even know if they went forward.

This was the first time I saw the change over my signature, and again, I don't know what action was taken on it.

Mr. BRYANT. What is the organization of DCAA? Who is at the top of it?

Mr. SPANTON. The director is Charles Starrett.

Mr. BRYANT. And what is his relationship?

I assume this agency is part of the Defense Department. What is his relationship to—let's say relative to the Secretary of the Army, Secretary of the Navy?

Mr. SPANTON. Well, he works for Assistant Secretary, Comptroller's Office, who reports to Weinberger.

Mr. BRYANT. He works for who?

Mr. SPANTON. Assistant Secretary of the Comptroller. It was Puritano. I don't know who it is now.

Mr. BRYANT. Well, in your role when you left there, it was what?

Mr. SPANTON. I was the audit manager at Pratt & Whitney, with a staff of about 30 people.

Mr. BRYANT. And you had been with DCAA for about how long?

Mr. SPANTON. Since its inception in 1967.

Prior to the establishment of DCAA, there were three audit services, the Army, Navy, and Air Force.

The Navy audit agency was the only one that had the authority to question costs. The other agencies were merely advisory to procurement, a very significant difference.

If I was examining these costs that we are talking about here for the Navy, during the days of Navy audit operations, I would issue a disallowance. And the only way the contractor would be able to recover these costs is to go to court.

The procurement activities could not reinstate these costs.

Under the philosophies which were used by the Air Force, and which is the present way that the DCAA operates, the DCAA is merely advisory. They just recommend and the procurement activities can do what they want with the recommendations.

Mr. BRYANT. Based on your experience at Pratt & Whitney, had Pratt & Whitney been contracting with a private concern rather than with the Government and the normal scrutiny had been applied to their spending and billing policies, what percentage of the overall expenditures that we made to Pratt & Whitney could have been saved?

Mr. SPANTON. Well, realistically, I would say one-third of their costs.

Mr. BRYANT. One-third of everything the Government paid Pratt & Whitney could have been saved?

Mr. SPANTON. Yes, sir, if they were prudent in the ways of their operation. And I would say that same rule of thumb would apply to virtually every defense contractor in the country.

Mr. BRYANT. That's amazing. Thank you very much.

Mr. DINGELL. The time of the gentleman has expired.

The Chair recognizes the gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

Mr. Spanton, were you a witness in the grand jury proceedings taking place regarding this matter?

Mr. SPANTON. I was classified as a 6(e) witness, but I have not yet been called.

Mr. BILIRAKIS. Have you played a part in the investigation?

Mr. SPANTON. Yes.

Mr. BILIRAKIS. In what way?

Mr. SPANTON. Developing information and transmitting it to the FBI and discussing material with the FBI that we had previously furnished.

Mr. BILIRAKIS. Well, how did you get involved? Did the FBI first contact you?

Mr. SPANTON. I first got involved chronologically in February of 1982 when we recommended that investigation take place.

Mr. BILIRAKIS. Now you recommended it?

Mr. SPANTON. I recommended that an investigation be made of the types of expenditures that you are looking at right now.

Mr. BILIRAKIS. And you were still an employee of the DCAA?

Mr. SPANTON. Yes, I was the manager of that office. And I was disturbed that I couldn't get the request for investigation off the ground. I was also disturbed that we were instructed to discuss what we were planning to have investigated with the Air Force. In fact, the Air Force had established a rule with the DCAA, if there are going to be any investigations, they want to be made aware that this is going to happen. And I waited until July when, as I said earlier, I had this investigator show up at my office to say that he was there to investigate me.

It turned out to be fortunate, because I was able to convince this individual to carry forward my request for investigation, which ultimately got to the West Palm Beach FBI office.

Mr. BILIRAKIS. Did you notify this committee that that investigation has not been continuing as progressively as you might have liked to have seen?

Mr. SPANTON. Well, I didn't say that the investigation wasn't continuing. My comments to the committee were that I have had no word on activities by the people who would make a decision on whether or not they would prosecute, and I felt that over these several years, if the FBI saw that—and this is just my opinion now—that if the FBI found that they had sufficient material to keep them involved in their investigation for a period of a year and a half or so, certainly something would be coming out of it, and that the U.S. attorney would be making a decision toward at least issuing indictments.

But there has been silenced. There has been nothing coming out of that front.

Mr. BILIRAKIS. Mr. Spanton, you made comments a few minutes ago that as a Navy auditor, which is what your position was prior to 1967 as I understand it, all the auditors were pulled in and consolidated under DCAA.

Mr. SPANTON. Yes, sir.

Mr. BILIRAKIS. Well, as a Navy auditor, you had the authority to black-and-white just completely reject any claims; is that right?

Mr. SPANTON. Yes, sir.

Mr. BILIRAKIS. And there was no authority on the part of the contractor to repeal that rejection, other than to actually go to court?

Mr. SPANTON. That is right. Probably the only individual he could turn to was my superior.

Mr. BILIRAKIS. All right. But he could appeal to your superior, so he did have that remedy.

Mr. SPANTON. Oh, sure, yes. But the superior had a responsibility to audit costs, and the superior most usually supported, because he knew the auditor was carrying out his doctrines, and he supported the auditor's position. It was very rare when the auditor's position was overturned, which established an understanding on the part of the contractors that they were running a risk of not recovering costs if they weren't prudent.

Mr. BILIRAKIS. But, sir, did those superiors, under the Navy audit system—at least some of those superiors—turn out to be superiors under DCAA also?

Mr. SPANTON. Yes.

Mr. BILIRAKIS. Well, why wasn't the same sort of credibility between auditor and superior existent under DCAA as it was under the Navy?

Mr. SPANTON. Because most of the key positions when the DCAA came into existence were taken over by the Air Force in the DCAA.

Mr. BILIRAKIS. So the Air Force people are not as responsible and whatnot as the Navy people?

Mr. SPANTON. Well, I'm not saying the Air Force audit capability was any less than the Navy audit capability. They just did not have the authority to carry out their jobs as the Navy auditors did.

They had to submit their recommendations to procurement. That's the way they operated prior to the establishment of the DCAA.

Mr. BILIRAKIS. I see. So during the subsequent years after 1967 when you became part of the DCAA system, did you find yourself really placed into an advisory position?

Mr. SPANTON. Yes.

Mr. BILIRAKIS. Advising whom?

Mr. SPANTON. Procurement, the Air Force procurement office, the Navy procurement office, the contracting offices, administrative and contracting offices.

Mr. BILIRAKIS. Did you find yourself having as many problems with claims that were submitted after 1967 as you had prior to 1967? I mean, did you find as many problems with the claims that were submitted as you had before?

Mr. SPANTON. The only difference is that subsequent to 1967, when we found the same types of costs that we would question prior to 1967, they were submitted to the procurement offices for resolution, and we found most often the bulk of those costs were reinstated.

Mr. BILIRAKIS. All right. You found as many problems in your own subjective eyes—you found as many reasons to reject claims, but what you are saying is, you were overruled by your superiors in DCAA; is that correct?

Mr. SPANTON. No, not the superiors in DCAA. We were overruled by procurement.

Mr. BILIRAKIS. By procurement. You had a superior between you and procurement, did you not?

Mr. SPANTON. Well, you have the regional offices. But most often, the audit manager has a very strong responsibility and authority to make a decision, and if the audit manager is doing his job and he feels he has a solid position, he will reveal that position, regardless of what his supervisor says.

I remember a circumstance when a supervisor told me to accept costs, and I said I refused to sign the report. "He won't accept it; you sign it." I think that's what we have to do. That's my point. That's what we're getting paid to do, to take a position to represent not just the DOD, but the taxpayer.

Mr. BILIRAKIS. But you had a supervisor between you and procurement. Wasn't that supervisor in a position of supporting his auditor, you know, supporting his subordinate, so to speak, and wasn't there the credibility between your level of auditing and your supervisor existent?

Mr. SPANTON. But the supervisor under the DCAA method of operation was more attuned to maintaining harmonious relationships with procurement. So when you ran into serious issues, he would say to the auditor, "Well, you have stated your views, and whatever they do, you know, we have done the best we could," and drop it, rather than make it an issue and carry it up the line.

Mr. BILIRAKIS. When you were a Navy auditor, were you ever wrong in rejecting claims? Did you ever ultimately feel that maybe you made a mistake in rejecting a claim?

Mr. SPANTON. I might have, but my memory doesn't serve me that I had. I'm not saying I'm infallible. But when you are dealing with, as it was at Pratt & Whitney, when you are dealing with a half a billion dollars or more, then we become pretty knowledgeable on it. And it takes years to work up to the manager level. I have been a manager, as I say, my entire career with the Government, and I know my job.

Yes; we can have a difference in judgment on certain types of costs, and there can be errors made. But I would say my batting average would be pretty high.

Mr. BILIRAKIS. Why, in your opinion, would you feel that procurement continued to overrule you? And let me ask you, do you feel that that is a commonplace thing—do you feel that that is commonplace throughout the industry, where basically the DCAA or another person makes a decision to reject a claim, if you will, and then is continually overruled by procurement? Is that a commonplace thing?

Mr. SPANTON. Yes.

Mr. BILIRAKIS. Why would they do that?

Mr. SPANTON. Well, during the period 1972 to 1978, as I said, I was a supervisor over all defense contractors in the State of Florida, and I was exposed to the Army, Navy, and the Air Force procurement offices. I saw very little difference between the three of them.

Their major interest was in getting along with the contractors. And unless there were ironclad regulations that they could stand by, when it became a question of judgment as to whether it's reasonable or unreasonable, the judgments invariably fell in favor of the defense contractor.

As a general rule, I would say in the 50- to 75-percent range. In other words, if the auditor questioned $1 million, the odds were that the contractor would get three-quarters of that, if he didn't get it all.

Mr. BILIRAKIS. All right. Would it have been a promotion for you to move from DCAA into procurement and become one of those people above the DCAA, if you will, who would have these decisions to make?

Mr. SPANTON. It could have.

Mr. BILIRAKIS. It would have probably have been.

Well, what are we saying? That all people in procurement just don't have any integrity?

Mr. SPANTON. I didn't say that they don't have integrity. I said that they view their responsibilities differently than I do. And I can understand it.

You know, when General Dynamics—going back to my experiences with General Dynamics, they can take the position that they can hold the DOD—and essentially the Government—hostage. "You're either going to settle a claim on my terms, or else we're not going to give you submarines." Filtering down to the lowest levels, this is how the lower level procurement officers view their positions.

They have a military man over a civilian. A military man says to the civilian, "Buy those rifles." The civilian says he is having problems because he is tough on negotiations. He knows that his paycheck and maybe his job is on the line, because the military man says, "Buy those damn rifles; I don't care what it costs." So they negotiate as best they can, and the dice are loaded in the favor of the contractor.

Mr. BILIRAKIS. Well, my time is up. And, Mr. Chairman, if I may just finish up with a quick statement, I guess directed to Mr. Spanton, and that is that you ended up your remarks, sir, with a quote from a colonel, "It is the system. We can't change it."

Well, I suggest to you, sir, that we are all wasting our time here today if we don't change the bad parts of the system. And shame on us, because we are wasting taxpayers' dollars right here, sitting here today. Basically all we are doing is blasting the Defense Department or the Justice Department or the FBI or you or me or whatever the case may be. We are not really accomplishing anything.

I would like to see recommendations from you in terms of how you would change the procurement system. I'm not asking for it now.

Mr. SPANTON. Well, I have them.

Mr. BILIRAKIS. I'd like to suggest that you may submit them in writing to the committee.

Mr. DINGELL. We will continue to recognize the gentleman, in spite of the limitation on his time, for the answer to that question.

Mr. BILIRAKIS. Well, I'm not sure that we have enough time.

Mr. DINGELL. If the gentleman doesn't want to ask it, the Chair will. The Chair commends him for asking it.

Mr. SPANTON. Yes; I can give you one-liners and elaborate as you require.

I would start out by making procurement—the procurement agencies and the Defense Contract Audit Agency separate agencies, out from under the control of the military. The military establishes their requirements for weapons, and whether you take an IBM or any other major commercial operation, there are distinct barriers between the requisitioning process, the procurement process, and the audit process.

The procurement people should not have heavyweight military people—the civilians should not have these heavyweight military people breathing down their necks and saying, "Buy, buy." They should be free to get the best possible price without these pressures. And that would go a long ways to reducing this revolving door syndrome.

Similarly, the audit agencies should not have close ties to either procurement or the Department of Defense. Their responsibility should be to the Government and taxpayers, and they should be totally independent and forceful in carrying out their responsibilities.

And if and when they did establish a separate audit agency, they should take the Army, Navy, and Air Force audit agencies, who audit the military side of the house, and combine them with the auditors that are going to be auditing the contract side of the house, because you can't expect to get an independent audit out of some Air Force captain, who has a general for a boss, who is auditing the general's operation.

So the first step would be to establish the independence of the procurement operation and the independence of the audit operation.

Mr. BILIRAKIS. And this is the way it has been since the process was set up in 1967?

Mr. SPANTON. Yes. And I don't think it's very involved, but I would do something to close the revolving door, to eliminate any potential for influence by a contractor on his potential employee, some general, or again, going back to General Dynamics, it's incredible that these individuals in the Secretary of the Navy's office could have stepped in—incidentally, the review was never even requested by the DCAA of the GD claims. He just bypassed the Secretary of the Navy's office; he just bypassed DCAA. And DCAA, again not being aggressive, did not make an issue of that and resolve these claims.

Those actions should not be permitted. It's not in the best interest of the Government. And the question remains today, why was he permitted to do that?

There is a very serious situation about proprietary data. The contractor regards every piece of paper in his possession as proprietary data. And under 18 U.S.C. 1905, the only useful purpose that serves is to keep leaks of these abuses from getting to the Congress and the public. And it is put on every document the contractor has in his possession. It is to throw the fear of God into any of the Government employees who come into contact with these materials.

Mr. Dingell. If the gentleman would yield, this committee has had some problems with getting documents which were alleged to be proprietary in character.

Mr. Spanton. Well, your desk is loaded with documents they consider proprietary. I can understand, from the contractor's viewpoint, why he would consider proprietary information that he spent several thousand dollars on a party.

Mr. Dingell. Proprietary or a dark secret?

Mr. Spanton. So to me, again, yes, there is a need that certain information be proprietary. But clarify, and not make it blanket access to records.

The DCAA has all the tools they need to obtain access to records, but you've got to be forceful and aggressive. The audit profession requires forcefulness and aggressiveness to do the job properly.

And so I can say this: In my entire career with the Navy and with the Defense Contract Audit Agency, I never failed to resolve an access-to-records problem. The solution was simple. Don't pay the contractor, and you will get the records very quickly.

Tighten up the Federal acquisition regulations. Eliminate the loopholes, and eliminate the contractors' input into the writing of these regulations.

Mr. Wyden. Would the gentleman yield just very briefly?

Mr. Spanton, the way I understand it, you are essentially recommending what Dwight Eisenhower said many years ago, that we put civilians in charge of the contracting process and use that as the focus to ensure independence.

Mr. Spanton. I didn't know he said it, but I guess he was on the right track.

Mr. Wyden. Thank you. I appreciate the gentleman yielding.

Mr. Spanton. I have a few more. Should I go on?

Mr. Dingell. You are proceeding on the time of Mr. Bilirakis, which the Chair is regarding most charitably.

Mr. Spanton. We have to get away from, you know, these public statements that are essentially meaningless, you know.

Earlier, there was some talk about the certifications that contractors have to make, and really, whether they sign them or not didn't mean to much, because the way it was written, they always have an out. If they didn't have an out, they wouldn't sign it.

But put some teeth into the violations. As we heard earlier, very few of these people get indicted and go to jail, but they are stealing from the Government. They are harming our defense; they are harming our economy. And something more strong than just taking back the money they shouldn't have had in the first place—it's white-collar thievery.

I think the penalties ought to be severe to discourage this. Again, in my humble thinking, these are not—we could launch people to the moon, but we can't correct simple organizational deficiencies. And that's what we are talking about.

Certain areas of costs, very simply abolish them. The Department of Defense and the Government don't need Washington offices. If the contractors want to pay for it, let them pay for it out of their profits.

Consider the law involving excess profits, where if contractors do make excess profits, then you have a board, a renegotiation board to look at those situations to recover the excess profits. That was established, I believe, during World War II and existed for some time, and it served a useful purpose.

There are billions and billions of dollars of Government facilities in the hands of the contractors and very little accountability. In fact, the audit agencies were eliminated from auditing the Government facilities, all this special test equipment, tooling, going into the billions of dollars, which is virtually out of control. Get an assessment of where we stand and reexamine the DOD expenditures for facilities.

We did an audit of Homestead Air Force Base at the request of some major who was concerned that the supply people, the contractors supplying the needs of that base down in Homestead, FL, were delivering inferior materials. We went out on the base, and we found out that what his complaint was about was, in fact, actually happening. But we found beyond that virtually no control on the base, on the military side, on control of government materials.

For example, one situation I remember is, the Government would buy or the base would buy air-conditioning units with 5-year warranties on compressors. They would plug them in; the compressor wouldn't work; they would throw it in the scrap heap instead of returning it, and at the end of the day, these workmen would throw these compressors on a truck, take them home, turn them in, and they had businesses on the side. The employees, plumbers and electricians would show up with pickup trucks, load up their trucks with supplies and materials and work around the base and at night go home with all these extra materials. No controls at all.

So I'm saying, tighten up on what we have. It's not difficult. It's just doing business as business should be done on a major scale, and that is efficiently and effectively.

The labor I spoke about earlier, there's no reason in the world why the President should make—well, I guess he makes a couple hundred thousand dollars a year, and some man running a plant with 10,000 people makes $1 million a year.

Well, why shouldn't he make $1 million? Nobody's telling him he can't put it in for a claim. And in fact, he is serving his company, because when he gets $1 million a year, that $1 million is going to pick up 15 to 18 percent profit for the company, because he is increasing his costs. The more he spends, the more he's going to make.

These are not insurmountable corrections to the system, but each one of these affects groups of individuals that are benefiting from the way the system is operating today.

The spares, so totally unorganized that the only one who benefits by it is the Russians, because the waste is so tremendous. You might have 50 different bases in the United States, each one ordering one part. Defense will order 50 individual units. They won't order 50, but they will order one at a time. That's why you see the $500 and $600 toilet seats. And again, the DCAA, with their philosophy that we have to have high productivity, won't audit a toilet seat; there's not enough money in it.

Mr. **Bilirakis**. Mr. Spanton, basically the bottom line, then, of this long list—I have learned a lot from you here today—the bottom line is, it's the Government again, isn't it? I mean, we have a defense contractor who is faced with regulations which are so hazy that two different DCAA groups might feel differently about claims regarding those areas, and possibly the contractor by taking advantage or not taking advantage, but I suppose maybe in a sense it is human nature to take advantage when it isn't black-and-white and clear.

So you're saying it still falls down to the Government. We don't have the proper checks and balances. We don't have the proper independence, one agency from another, and that sort of thing. So it comes down to changing things as far as the Government is concerned, doesn't it?

Mr. **Spanton**. Yes, I think you are right, sir. I think the Government has the primary responsibility. However, I do feel that these major defense contractors have, let's say—perhaps it's corny—but a patriotic responsibility as well. They know that these expenditures are intended—the vast majority of the public wants a strong defense. They don't mind spending money for a strong defense. So why don't these defense contractors give it to them without being as greedy as we are seeing by some of the examples that you are talking about over here?

Mr. **Bilirakis**. Thank you.

Mr. **Dingell**. The time of the gentleman has expired.

The gentleman from Minnesota.

Mr. **Sikorski**. Thank you, Mr. Chairman.

I, too, would like to add my commendation to that which has already been expressed to you, Mr. Spanton, for the efforts that you have already expended and, I hope, will continue to expend.

Did I understand you correctly earlier when you said that you have not appeared in front of a grand jury on this matter?

Mr. **Spanton**. That is true.

Mr. **Sikorski**. Yet——

Mr. **Dingell**. You said you had not appeared in front of a Grand Jury?

Mr. **Spanton**. No, I have not been called.

Mr. **Sikorski**. No, he has not.

Mr. **Dingell**. You are not bound by the grand jury rules?

Mr. **Spanton**. Well, they said I am. I'm not completely familiar with the rules. Perhaps I ought to become so.

Mr. **Sikorski**. You have not talked to the FBI or the Department of Justice in terms of your testimony here today, I take it?

Mr. **Spanton**. No, I haven't. But I was told that I am bound by the rules of 6(e). I am a potential witness under 6(e). I am kind of hazy as to what that means.

Mr. **Sikorski**. That means if you learn something in the Grand Jury process, you can't share it outside the grand jury, quite simply.

Let me, on that matter, focus on the issue of this wining and dining of defense people. As I understand it—and we read about the sport fishing, cruises set up for some generals and others—we see in your testimony that you have got some inadvertently obtained invoices that showed that Pratt & Whitney were entertaining military personnel and other Government officials in apparent violation of the law. And as part of your concern about the Anti-Kickback Act, you asked for some clarification of this.

You later on got a visit by Mr. Batson of the Investigative Service. You turned over that stuff to him eventually, and that's what started this investigation that you have not been called in to participate in; is that correct?

Mr. **Spanton**. That's right. The only investigation that I could get going during that timeframe was of myself. In fact, I think there were three separate threats of investigation during that same period, all of me.

Mr. **Sikorski**. But the district attorney down there hasn't called you. Of course, you live nearby, don't you?

Mr. **Spanton**. Yes.

Mr. **Sikorski**. And you have a phone number that was accessible to those people; is that correct?

Mr. **Spanton**. Yes.

Mr. **Sikorski**. But you haven't been called?

Mr. **Spanton**. No, I haven't been called.

Mr. **Sikorski**. We turned over some of the stuff under the General Dynamics investigation of this kind of wining and dining, and, of course, you talked about it in the Washington office.

Today we received, or our chief counsel received, a letter from the DOD inspector general's office from the assistant inspector general. It says.

> This letter is to advise you that the Defense Criminal Investigative Service has opened an investigation concerning allegations that General Dynamics Corporation provided illegal gratuities to various senior Department of Defense officials. This investigation is predicated on information provided to the Defense Criminal Investigative Service by the staff of your committee.

As an aside, of course, those were the kind of vouchers and things that you saw down at Pratt & Whitney and the kinds of things that are routinely handled by the auditors; isn't that correct?

Mr. **Spanton**. That's correct.

Mr. **Sikorski**. Well, they had to get it from us, with our limited resources. And it goes on to say,

> In general, the investigation will focus on the facts and circumstances pertaining to DOD officials attending the Caribou Hall, the "Irongate Ball" and other similar events as the guests of General Dynamics or other DOD contractors.
>
> In addition, investigation will seek to determine whether DOD employees were entertained by General Dynamics' Washington office or its corporate headquarters in connection with approximately $1.3 million per year of undocumented travel and entertainment expenses.

And it goes on.

It is good to know that they are moving, but of course this stuff came up 2 months ago. Even though investigations caused by your turning over the same kind of information, now 4 years ago, hasn't led to any action that you are aware of; isn't that correct?

Mr. **Spanton**. Well, they have made the investigation. It's just that we are waiting to see what they are going to do with it. And you heard from this morning's testimony that—well, there wasn't much said.

Mr. **Sikorski**. Did you find that as you sat over here and listened and watched, a kind of eerie feeling—did you have an eerie feeling that the same kind of response was being made by those that have power within the system to root out wrongdoing and prosecute it? Did you have an eerie deja vu feeling?

Mr. **Spanton**. Yes. I found very little difference between the rules being laid out for Mr. Cavanaugh and the rules that are followed within the Department of Defense. In fact, two curious situations.

I guess the DCAA has become so learned in the contractors' methods for withholding information from DCAA that they use these same techniques when they are visited by GAO or the IG. And time and time again, the IG has had complaints that the DCAA won't cooperate with them, and the IG is assigned responsibility.

In fact, I saw a memo. I have a copy of a memo from the DCAA in which they are telling their managers to inform their people that they are going to be visited by the GAO to look into why reinstatements are being made by Procurement of DCAA-questioned costs. And they were offering their auditors guidance that, "We want you to remember that you must be cautious and not be critical of Procurement when they come in and talk to you about it, because there are regulations against it."

Similarly, when the IG visited DCAA to look into problems of access to records or inflated cost savings or other areas, the DCAA informed their people that, "We don't like the techniques used by the IG investigators in talking to the auditors, without having supervisors present to protect them."

This is incredible, when you're talking about people within a professional audit agency getting that kind of guidance from their management.

Mr. **Sikorski**. I find much of this incredible. But true. You made a point that needs to be emphasized. People go crazy when they hear about 200 dozen golfballs, 5,000 baseball caps, and the 390 rose corsages for the flight fling ball and things like this—you know, the incredible million dollar salaries for a plant manager.

But you have to understand, not only are we getting ripped off there, but we are paying a 10 or 15 or 18 percent—you used the term 15 or 18 percent—on top of that. So that whatever they shove down this tube for reimbursement comes back in terms of that, plus so-called profit; is that correct?

Mr. **Spanton**. Well, probably the only business in the world where you can benefit by your mismanagement and inefficiency.

Mr. **Sikorski**. And that's what's happening here.

You mentioned earlier the certification process. You know, about 2 weeks ago—no, a week ago yesterday—95 million Americans filed their tax returns, and each one of them had a blank where they had to certify that what they were saying was the truth. You do this when you get a dog license or a fishing license or a car license. But currently, contractors don't have to certify that what they are billing for is true and accurate, or that they honestly earned that.

The Department of Defense Secretary announced a new get-tough policy on nationwide TV that he was going to make them certify. Then he backed off and quietly reversed himself. So we are back to a situation where it is final settlement.

You mentioned that they won't sign unless there's a way out of it, and now there is a clear way out of it.

What is your feeling about that?

Mr. **Spanton.** Well, when the stories begin to come out—for example, GD and all their abuses—apparently DOD management feels that it was a get-tough outward appearance. But anybody in the know would recognize quickly that it was not workable. Get tough, you know, some of the things we talked about here, and the other is just for appearance.

At the risk of being repetitive, everything I am saying, I can assure you, exists throughout the Nation. I probably could sell my talk a little easier if I said 10 percent is wasted, or 5 percent. I have got to say that one-third of the budget is going down the tube, because nobody cares and because so many people benefit. It's as simple as that. It's in every area that you touch.

Mr. **Sikorski.** And one-third of the $3 billion is a waste?

Mr. **Spanton.** Well, I'm talking about procurement. If the procurement budget is $125 million or billion, $125 billion, then I'm saying you are looking at the potential of one-third.

If there was efficient management—and I'm not talking about being unreasonable; I'm talking about sound business judgments were followed—then the cost savings could be enormous. And again, I am not talking about these types of cost savings reported by DCAA which go up in smoke. I'm talking about real, substantial savings.

They are there, if you would take the actions to get them.

Mr. **Sikorski.** You are saying that if we squeeze this Government, if we made this Government as efficient as we should make it, allowing for human nature, if we eliminated fraud and waste and abuse in just this one area of procurement, the taxpayers of this country would be $40-some billion richer?

Mr. **Spanton.** Add one more ingredient, and that is, require them to become efficient. Improve the methods of competition, take a few risks, where if GD tells you, "We're not going to give you submarines," tell them to keep the submarines. You've got to get tough someplace along the line.

It's incredible to me that the Government, the buyer, gets dictated to by the seller. And the buyer put the seller in business to begin with.

Mr. **Sikorski.** I thought it was Dwight Eisenhower, again, who said: "You buy what you need, not what they have to sell," and we have turned that over.

Mr. **Wyden.** Would the gentleman yield. I appreciate it. I just want to ask one other question.

You mentioned a number of very good changes for legislation. But isn't it going to be critical to change the attitudes at the top, because it seems to me, we could have all the legislative changes in the world, but until we change these attitudes at the top, where either we just look the other way or in some way say that we are not going to embarrass the contractors or embarrass the services, it's never going to change?

And I would just like to hear your thoughts in terms of changing the attitudes at the top.

Management at the top has to understand its responsibility and get tough. The people either have to play by the rules and do their jobs or get out and let people in that will do their jobs.

I am saying this is not something that requires a miracle to achieve; it is just good sound business. It can be done. It can be done without mirrors. It's not difficult. But you have to have the desire to do it.

Mr. WYDEN. Well, I think it is going to take a real change of attitude, as well. We need these legislative changes. We need these kind of organizational changes. But until we clean out some of this approach from the top that just says the contractors are in a position to work things out and get the price they want, I think we are still going to have a lot of problems.

I thank the gentleman for yielding.

Mr. SIKORSKI. And I thank the Chairman and Mr. Spanton.

Mr. DINGELL. The gentleman from New York.

Mr. ECKERT. Thank you, Mr. Chairman.

During your auditing of Pratt & Whitney, did you uncover any evidence or acquire any information that led you to believe that Pratt & Whitney demonstrated an intent to defraud the government by improperly billing certain overhead costs?

Mr. SPANTON. Well, to me, the intent is the same as accomplishing it. If they take expenses that we are looking at here and put them into an account, and if for some reason there has been an attempt to distinguish whether the costs were actually paid, again, in my mind, if the defense contractor puts these costs in an account which is identified as one which will make up a claim for payment, as far as I'm concerned, that's an intent to collect on costs that should not be allowed, and that's an intent to defraud.

Furthermore, it is a frequent occurrence, and it happened at Pratt & Whitney quite recently where they have current information and don't reveal it to Procurement Operations, so that, for example, Pratt & Whitney might have in their proposed new contract costs of the subcontractor for $25 million, and that makes up the cost of the new contract. In their hip pocket they have a proposal from another subcontractor for $20 million. After they get the contract, they drop the $25 million supplier and go to the $20 million, and they pick up a $5 million quick profit.

If the Government discovers this, the recovery is defective pricing. To me this is out and out fraud and should be prosecuted. But if you go into the records, I doubt if you will find very many prosecutions of these situations as fraud. They merely—it's the same action that occurs throughout these entertainment and other costs. If you find it and you pressure us, you might get it back.

Mr. ECKERT. All right. But the answer to my question is yes, unequivocally yes. You are saying that you did uncover evidence or acquire knowledge of intent to defraud. You answered that really by saying yes, did you not?

Mr. SPANTON. Yes. I'm saying—I'm not a lawyer, but to me this is an illegal claim.

Mr. ECKERT. Did you, then, ever recommend prosecution on those grounds?

Mr. SPANTON. Well, we recommended that this be turned over to the FBI, who in turn would turn it over to the U.S. attorney for prosecution. That's the action we took.

Mr. ECKERT. OK.

Mr. Spanton, did you ever apply for employment with any defense contractor?

Mr. SPANTON. No.

Mr. ECKERT. No? Never?

Mr. SPANTON. No.

Mr. ECKERT. Would some of these disputes, or many of them, between the Government and defense contractors regarding allowability of overhead expenses be avoided if the rules that you operate under were a bit more clear?

Mr. SPANTON. I think if there were rules governing what is allowable and what is unallowable and they were clearcut, certainly it would eliminate a lot of the problems we are discussing.

Mr. ECKERT. But, essentially, do questions regarding the allowability of costs result from vagueness of the Defense acquisition regulations or from misapplication of those regulations?

Mr. SPANTON. It's a combination.

Mr. ECKERT. Well, which more than the other?

Mr. SPANTON. Vagueness. Vagueness in the regulation.

Mr. ECKERT. Well, isn't that saying, in effect, that the Federal Government is more to blame than the contractors?

Mr. SPANTON. It is an outfall of the military industrial complex where the military and the industry work closely together. The military work up the regulations. Before they put them into effect, they submit them for review by the defense contractor organizations. They make their recommendations, and then they become regulations.

Mr. ECKERT. But you are saying the rules themselves are loose and you don't want people to play by loose rules.

Mr. SPANTON. That's right.

Mr. ECKERT. Are the regulations written in such a manner that they promote the practice of attempting to bill all questionable expenditures to the Government and then paying only those which the Government auditors question or disallow?

Mr. SPANTON. Yes.

Mr. ECKERT. Again, then, isn't that poor management by the Federal Government? You were talking about the procedures of the contractors, and you made many valid criticisms; but essentially here what you are saying is that the Federal Government is poorly run, mismanaged.

Mr. SPANTON. They have to accept primary responsibility.

Mr. ECKERT. You are saying that the area in which you used to work was not very well managed, right?

Mr. SPANTON. Yes; that's right, and that is the Department of Defense.

Mr. ECKERT. All right. But it is really—I mean given human nature, people tend to get away with what they can get away with, and you are saying that the management is set up in such a lax manner as to permit virtually the maximum.

Mr. SPANTON. Yes; but these managements can get away with all these things because, of course, of the immenseness of the budget and the huge contracts that these contractors get. Whatever the levels that they set, they get these funds.

Mr. ECKERT. How are the Defense acquisition regulations developed?

Mr. SPANTON. They were developed by a board setup procurement activities together with—I guess they got representation from the auditors, and eventually input from the defense contractor organizations.

Mr. ECKERT. Are you saying the system needs a complete overhaul or a fine tuning? Which?

Mr. SPANTON. Well, I am saying if I'm a buyer and if I want to set up rules, I have the money, and so if I want to say how much I will accept in the form of travel, I will lay it out specifically, this is how much I will accept. If I say you can spend all you want but I'm only going to reimburse you $75 a day for travel for your employees, that's it. That's clearcut.

But when it's written that way and submitted to these contractor organizations, they will come back, and in the very last paragraph it will say, "However," and then you can forget it because they have included the loopholes.

Mr. ECKERT. You made some interesting specific suggestions which I applaud. I was wondering if you could add some specific recommendations that you might think of that would ensure that disputes regarding the allowability of expenditures could be avoided, or at least significantly diminished. I don't believe you addressed that.

Mr. SPANTON. Oh, yes; I think that if the rules on the allowability of costs were spelled out by a committee representing the Government, and only the Government, where they have seen the areas that the loopholes exist, they can put together these rules.

For example, on the question of advertising, they have loopholes. They should say all advertising is out if they won't allow classified advertising. They can get very specific about it. They can put limitations on it. They could use dollar amounts. They can establish limits on travel. All entertainment is out.

Pratt & Whitney, talking about meals, had a rule where they said people working for Pratt & Whitney who went out to lunch or dinner at their home locations had to pay for them themselves, and that there should be minimum situations where they can call them conference expenses. But, of course, that's a common occurrence. You have a group of 10 or 12 engineers who go out to dinner, spend a few hundred dollars, and they say, well, it's a conference expense, and they claim it. It is common. They consider in defense contract work it goes with the job.

Mr. ECKERT. Well, thank you very much.

Mr. Chairman, I have no further questions.

Mr. WYDEN [presiding]. Let me ask you a few additional questions, Mr. Spanton.

One area we are interested in is spare parts, and, of course, you were auditing the spare parts accounts at Pratt & Whitney. It is my understanding you discovered that the Air Force paid $1.4 million for spare parts that cost $531,000; is that correct?

Mr. SPANTON. Yes.

Mr. WYDEN. Was this excess refunded to the Government after you discovered it?

Mr. SPANTON. No; because this is the way Procurement initiates its buys. It works through a supplier. In other words, instead of going direct to the sources where they would have paid $531,000, they bought it through Pratt & Whitney, and Pratt & Whitney didn't even buy it from the sources; they bought it from Bendix. So, Bendix tacked on roughly a half-million dollars, Pratt & Whitney tacked on roughly another half-million dollars, and the Air Force was satisfied to pay $1.5 million for something that the Air Force could have gone directly to the supplier and paid a half-million.

Mr. WYDEN. And you see this as a pretty typical way of doing business?

Mr. SPANTON. Very common.

Mr. WYDEN. A garden variety type transaction? We are out close to $1 million, and it happens all the time?

Mr. SPANTON. It is common.

Mr. WYDEN. Did Mr. Paul Evans, the DCAA regional director, threaten you in any way in 1980 if you failed to take an early retirement? It is my understanding he said that he would make it tough on you if you don't.

Mr. SPANTON. Yes; that's true.

Mr. WYDEN. Is Mr. Evans still with the DCAA?

Mr. SPANTON. Yes; he is still the manager in Atlanta.

Mr. WYDEN. In what way did Mr. Evans make it tough on you?

Mr. SPANTON. Well, he suggested in 1980 that it was time that I retired, and I would benefit by the opportunities of retirement. I told him I had a son that was still in high school and I just wasn't ready to retire; furthermore, I enjoyed what I was doing. His message to me was he said not only does he feel I should retire, but so did the people up in headquarters; headquarters DCAA feel I should get out, that it would be in my own best interest.

I decided to hang in, and I told him eventually. I said: If you want to fire me, then go by the rules and fire me, but I'm not going to make it easy for you and retire. And I hung in. Since that point in time, it is the usual routine. Your performance rating plummets from the top to the bottom, and then they subsequently ascertained that I was needed in an office on the west coast. That's in California. And it's the daily ongoing comments, the pressures to push a man out.

I know many individuals that just shrugged and said "I can't take it" and walked out. I was just a little too stubborn, and I maintained the position that I'm going to hang in, I am legally entitled to and I'm going to do it. And if they can get them out, then let them try.

So, they pursued this course of investigating me, and in fact, I saw a letter from Puritano, the Assistant Secretary of Defense Controller, apparently written by the Director of the DCAA and submitted to Weinberger, in which it said that it referred to me as a troublemaker.

Mr. Wyden. Let me ask you about that because we are going to have the DCAA Director, Mr. Sterrett, here tomorrow. Now, did he give you a 60-day ultimatum to accept a transfer or be fired?

Mr. Spanton. Yes.

Mr. Wyden. Did he tell you that your effectiveness as an auditor would be impeded because Pratt & Whitney had voiced an intention not to provide you with the relevant data?

Mr. Spanton. Yes.

Mr. Wyden. So, what we have here in this situation is the head of the DCAA, your ultimate superior, is essentially getting together with a major league defense contractor to deny you, an auditor in the Agency, access to the records you need to do the job. That's, essentially, what went on in the situation.

Mr. Spanton. Yes.

Mr. Eckert. Could the Chair yield to a question?

Mr. Wyden. I would be happy to yield.

Mr. Eckert. On a similar point, each member of the committee has an article about you called "The Persecution of a Pentagon Whistle-Blower." The publication is not identified, but in it, it says that the DCAA Director, when he was going through these disputes with you, charged you with "the unauthorized and premature release of contractor information to the press."

Is that an accurate charge against you?

Mr. Spanton. I did talk to the press. I didn't release documents, but I did talk to the press when I essentially struck out in going first through my Agency, then through the various hotlines, the GAO, the IG, the several others, and even contacted some Members of Congress and was unable to get the message out that we have a serious problem. I took it seriously, that we had a problem that I felt affected the Nation, and I did talk to the press.

I don't remember the information that I released to them. I don't know. I think at the time it might have been referenced to this labor review that we were performing that I felt should get the attention of the Agency and the Department of Defense.

Mr. Eckert. Well, in fairness to you, in the article in parentheses it says details of Pratt & Whitney's expense account and salary policies was the sort of information that apparently he charged you with, and it said that these expenses were really unauthorized.

Now, what kind of restrictions were you operating under?

Mr. Wyden. If I might reclaim my time, I think the gentleman has answered the question.

Mr. Dingell. Mr. Spanton, the Chair has some questions that I would like to direct to you at this particular time.

We have here a number of vouchers. I would like to go right through these if I could, please, and they will be numbered as we go through. Let us refer to a group of vouchers and papers marked No. 1. It is entitled, "Pratt & Whitney Aircraft Group," and it is voucher No. 96951, Government Products Division, Post Office Box 2691, West Palm Beach, FL. Voucher for King David Hotel in Jerusalem, $3,231, and a check photostated below.

Then attached to that is an item entitled "Check Request Form." To Charlie Feeley from Ernie Wright/Joe Jaswinski, Extension 2428. "Would you please request a check as follows: amount $3,231. Issued to King David Hotel, Jerusalem, Dinner function in Israel. Expense associated with customer business discussions concerning proposed changes in government acquisition policy."

Then a continuation, deposit, bill, and so forth. Signed by, it looks like, Ernest B. Wright.

What is this collection of documents, if you please?

Mr. **Spanton**. This is just an example of a document that they charged into the account, an overhead account, which was put in their claim. As much information as you read there is what the auditor would have.

Mr. **Dingell**. The check was issued. I assume this was charged to the Government?

Mr. **Spanton**. Yes, sir.

Mr. **Dingell**. Was there any question in connection with this charging to the Government?

Mr. **Spanton**. Yes; we questioned it.

Mr. **Dingell**. But it was charged nonetheless?

Mr. **Spanton**. Oh, yeah; well, we don't know until we review their accounts and review the papers that it was in there. They don't bring it to our attention. They just go ahead and charge it into the recovery account, the Government account; and it is only by audit that we uncover these.

Mr. **Dingell**. I see. Whose government acquisition policies were they discussing, the United States or Israel?

Mr. **Spanton**. Your guess is as good as mine. Probably Israel.

Mr. **Wyden**. Mr. Chairman, if you would just yield briefly, it is my understanding that it's against the law to do that. If we could ask staff on that.

Mr. **Dingell**. What was this for? Was this for foreign selling costs or what?

Mr. **Spanton**. That's what it appeared to me.

Mr. **Dingell**. If it is foreign selling costs—in other words, the cost of sales to Israel—did they charge it to the U.S. Government?

Mr. **Spanton**. That's what they did.

Mr. **Dingell**. Now, I have here another one. It is Government Products Division, again. Oklahoma Art Center. Invoice No. 23200. Invoice Amount $67,500. Following that is a letter to Maj. Gen. J.T. Edwards, Commander, Oklahoma City Air Logistics Center:

> Dear Jay: As we discussed, the Government Products Division of Pratt & Whitney will be pleased to help sponsor the Phillips Collection at Oklahoma City. We will fund 50 percent, or $67,500, and expect to send the Oklahoma Art Center a check soon.
>
> As you know, we are very much interested in projects that promote the arts, and I think the Phillips Collection will be a marvelous addition to the area's already fine cultural environment. Pratt & Whitney feels very much a part of the Oklahoma City community and is glad to have the opportunity to make this contribution.

Then under that there is an item entitled, "Internal correspondence, to Tom Aiton from Jim Nelson, Oklahoma Art Exhibit Funding, June 23, 1982. Please draw up a check for $67,500 to cover Pratt & Whitney's contribution in support of the Phillips Collection

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exhibition at the Oklahoma Art Center. The check should be made out to Oklahoma Art Center." Signed, Jim Nelson.

What is this?

Mr. Spanton. That's just another charge, another one of these extraneous charges that went into Government accounts for recovery from the Government.

Mr. Dingell. Now, this was an item which was charged to the Federal Government, was it?

Mr. Spanton. Yes; and it was included in the overhead accounts intended for recovery from the Government.

Mr. Dingell. OK. Now who, by the way, is General Edwards?

Mr. Spanton. He had headed up the procurement activity out in Oklahoma.

Mr. Dingell. Headed up what, a procurement arts business?

Mr. Spanton. No; the procurement of spares.

Mr. Dingell. Oh, the procurement of spares.

The letter from F.W. McAbee, Jr., president, Government Products Division, to Major General J.T. Edwards, goes on to say: "We are very much interested in projects that promote the arts." Is he referring there to Pratt & Whitney, or is he referring to the Federal Government, since the Federal Government is being expected to pick up the tab?

Mr. Spanton. In this case, sir, the Federal Government.

Mr. Sikorski. Would the gentleman yield?

I wonder if Mr. Spanton knows where retired Maj. Gen. J.T. Edwards is now.

Mr. Spanton. I had heard, and I don't know if it's accurate, he is still out—I think he is still in that particular area of the country.

Mr. Dingell. Is he still in the same position, or is he working for Pratt & Whitney now?

Mr. Spanton. No; I can't tell you.

Mr. Sikorski. I thank the gentleman.

Mr. Dingell. We have here an item which we will identify as exhibit 3. It is a photocopy of a check in the amount of $33,268.31. Above it is apparently a voucher and attached thereto is apparently a series of charges made at The Breakers, billed to Pratt & Whitney, Quarter CENCL, Ms. Gail Heiss, P.O. Box 2691, West Palm Beach. Included are a number of items, wine $3,249.53, banquet function beverage, $5,697.33.

Is this item which we will call exhibit 3, was this billed to the Federal Government?

Mr. Spanton. Check No. 33448, yes, sir, billed to the Government.

Mr. Dingell. It was?

Mr. Spanton. Yes.

Mr. Dingell. Was it challenged?

Mr. Spanton. Yes, sir.

Mr. Dingell. It was. Was it paid?

Mr. Spanton. I can't tell you. I am not on this—in fact, these costs will not have been reimbursed because they were subject, all of these costs were subject to scrutiny by the FBI, and so they are on hold until some decisions are made.

Mr. Dingell. But let's try and analyze this thing, because I think we have got kind of an interesting set of phenomena here.

They billed these items to the Government as overhead. They receive progress payments on this, do they not?

Mr. Spanton. Yes.

Mr. Dingell. Even though they are ultimately disallowed, then the contractor would have the use of the money during that period, pending the disallowal; right?

Mr. Spanton. Yes.

Mr. Dingell. Now, the usual way, as I understand it, is that these matters are negotiated out; right?

Mr. Spanton. Yes.

Mr. Dingell. So if it is disallowed in part, the contractor very well knows he is going to get back a part of what he should not have gotten in the first place. In other words, if it's an item here, for example, as we had indicated, of $33,268, he knows that he is not entitled to it, but (a) he gets the use of the money during the period that he's giving progress payments, and if it is compromised out 50 or 75 percent, he winds up getting 70 percent of what he should not, and he gets the use of the money because of the progress payments pending the time that it is finally disallowed or negotiated into settlement. Is that right?

Mr. Spanton. Yes, sir; that's right. In addition, it is very often the case to make the resolution of the problem they settle on the basis of a package so they don't identify to the reinstating of any particular amount, but they have numerous different areas—so they do it as a package. And whichever item you pick out, they say, "Well, that's the one that we questioned in full."

Mr. Dingell. They have perfected their techniques to a remarkable degree.

Let us observe an item which we will now call exhibit 4 in this discussion. It is an item of $3,400 to Florida Golf & Tennis. There is a voucher and a photostat of a check copy together with certain items here, apparently in support of it. "DT-90 Titlist Top Quality Golf Balls with Pratt & Whitney Aircraft imprinted in blue." I gather that is the corporate logo. Charge, $3,400. Was that billed to the Federal Government as part of overhead costs?

Mr. Spanton. Yes, sir.

Mr. Dingell. Was that disallowed?

Mr. Spanton. Yes.

Mr. Dingell. It was disallowed?

Mr. Spanton. Well, I'm saying——

Mr. Dingell. You questioned it?

Mr. Spanton. That's right.

Mr. Dingell. But you don't know——

Mr. Spanton. We don't know whether they will collect on it.

Mr. Dingell. Does the auditor have any way of knowing whether his recommendations are accepted or not?

Mr. Spanton. Sometimes. It depends upon the negotiation. If they do it by individual item, then he might know. If they do it in a package, he won't know. Even so, if this was part of a group of costs being questioned, he wouldn't know which one of these vouchers they collected on, because they do it on a percentage basis.

Mr. Dingell. Now we will call this one exhibit 4 in our current discussion—No. 5, I beg your pardon. Check for $1,255.05, bookkeeping voucher above it, item No. 245708. It reads: Capt. Bud

Smith, 732 46th Street, West Palm Beach, three cases of beverage, three sports fishing charters all days, 1½ case cola, food, cookies, chips, one dozen live bait, crew gratuities of $40.

Was this billed to overhead accounts of the Federal Government?

Mr. SPANTON. Yes, sir.

Mr. DINGELL. Did you recommend against it?

Mr. SPANTON. Yes.

Mr. DINGELL. Do you know what happened to it?

Mr. SPANTON. No. Again, this is an item now under the purview of the FBI.

Mr. SIKORSKI. If the chairman would yield, the ratio of booze to bait is one case—three cases of booze per one dozen live bait in this instance.

And I note on the next page, I think there are 13 or 15 people, 16 people for one dozen live bait.

Mr. WYDEN. Mr. Spanton, who are the people who go on these excursions?

Mr. SPANTON. That is not very often known. Sometimes you have a listing.

Mr. DINGELL. Do regulations require that the beneficiaries of these sorts of gratuities be identified?

Mr. SPANTON. Well, if there weren't Government regulations, still normal business regulations in any commercial operation, in the final analysis, the stockholders should be knowing how their monies are being spent. And in the case of General Dynamics, I recall they had rules which prohibited—which was most unusual—prohibited their people from recording who they were entertaining.

Mr. DINGELL. Now assuming that they are disallowed in part and bulk, can they rise again to attend to us for further settlement?

Mr. SPANTON. No, no, not on this particular cost. It will happen again next year, and the scenario will be the same.

Mr. DINGELL. Well, staff brings to my attention here we have affiliation, and it says boat 1, Bob Frazier, GPD, Bjoerge Hansen from Norway; Van Rafelgheim, Belgium; John Harding, P&WA, Washington; Mr. Schwab, P&WA, boat 2, Mr. Withers, P&WA, Vosiniotisi; Greece; Weller, Australia; Keown, New Zealand; Hall, Great Britain; and boat 3 is kind of hard to recognize, but one is from GAC; none from MDC; and one is from Israel.

Does this say that this might have been a foreign sales undertaking?

Mr. SPANTON. Well, it says here foreign air attaches. I don't know. But, of course, you see, I see as much information as you do, and there's not enough to really understand. But on the face of it, it should never have been claimed and certainly should not be allowed.

Mr. DINGELL. Let us look now at a check and internal voucher to Callaway Gardens in the amount of $1,844.44: items for room charges, room charges, room charges, room charges, room charges, room charges, and garden restaurant. Plus I note four golf fees, $93.60, $93.60, $187.20 and $35.89.

Was this item disapproved or did you recommend disapproval?

Mr. SPANTON. Yes.

Mr. DINGELL. Do you know whether it was paid or not?

Mr. SPANTON. I don't know.

Mr. DINGELL. Is this the kind of expenditure that is approved routinely, or is it justified for expenditure?

Mr. SPANTON. Certainly not.

Mr. DINGELL. We come now to what we will call exhibit 7. No, let's go back to 6 for just a minute here. Business guests report information. It goes to Mr. and Mrs. Missimer, Mr. and Mrs. Van Overschelde, GPD affiliation. What is GPD?

Mr. SPANTON. Government Products Division, Pratt & Whitney.

Mr. DINGELL. That was Pratt & Whitney?

And then Mr. and Mrs. Overend and Mr. and Mrs. Pelehack Grumman. So I gather that Pratt & Whitney is entertaining Grumman and charging the Government for it?

Mr. SPANTON. Yes, sir.

Mr. DINGELL. Now we come down here to the next one which we will address as exhibit 7, and I see here a check for $34,465.69. On the second page it appears to read: LCD clock with custom logo, silver with PMS No. 294 blue, one-time set-up charge, $5,989.63. Another reads: 7/8ths inch round key rings with custom logo, silver with PMS 294 blue, and one-time set-up charge. This item is $3,230. The prior one was $5,989. Another reads: Suede russet key tags, cowhide leather luggage tags, a total of $3,542.92.

I gather you recommended disapproval of this item?

Mr. SPANTON. Yes, sir.

Mr. DINGELL. Why?

Mr. SPANTON. Well, because it's certainly not necessary to do the government work, to build engines.

Mr. DINGELL. Let's go to an item relative to Queensway Hilton, $7,853.51. The document says: CX Douglas Cocktail reception, Pratt & Whitney Aircraft Group from customer relations, "To Charlie Feeley per your request you have check request. Marlene." It says ice carving, $225, two bartenders, it looks like, one cocktail waiter, total $330, and a number of other items apparently relative to this. It's described a in Queensway Bay Hilton invoice as being a cocktail reception. And finally, a check request form from Charlie Feeley. It is described as a CX-Douglas cocktail reception.

Did you recommend approval or disapproval of that particular expenditure?

Mr. SPANTON. Disapproval.

Mr. DINGELL. Why?

Mr. SPANTON. Again, unnecessary to building engines.

Mr. DINGELL. Let us come to one that we will identify as exhibit 9, check in the amount of $10,220.68. Pen and pencil sets with P&W logo. This was attempted to be charged to overhead account.

Mr. SPANTON. Yes, it was.

Mr. DINGELL. Did you recommend approval or disapproal?

Mr. SPANTON. Disapproval.

Mr. DINGELL. Do you know what ultimately became of this matter?

Mr. SPANTON. No. I believe it is still open.

Mr. DINGELL. We will now refer to what we will call exhibit 10, check in the amount of $19,150 to Gem Giftwares for P&W emblems, classic black ball pens, sterling silver ball pens, 10 karat GF pens, total $19,150.

Was there effort made to charge this to overhead account?

BEST COPY AVAILABLE

Mr. Spanton. Yes, sir.

Mr. Dingell. Was that approved?

Mr. Spanton. No.

Mr. Dingell. It was not? At least you did not approve it? You recommended against it?

Mr. Spanton. That's right. Again, to clarify, it is in the accounts. We would not accept it in our final report. Our final report would not have been issued until the FBI investigation is completed.

Mr. Dingell. Let's go to item 11, executive holiday season party at The Breakers, for $16,995. Is that an overhead item?

Mr. Spanton. That's what they are claiming.

Mr. Dingell. Did you recommend approval or disapproval?

Mr. Spanton. Disapproval.

Mr. Dingell. Was it approved?

Mr. Spanton. I don't know.

Mr. Sikorski. Mr. Chairman, is this that oldtimers' party, that executive holiday season party that you are talking about? People have been confused as to whether there was an oldtimers' or a goodtimers' party.

Mr. Dingell. We come to what we will call exhibit 12, 4,000 baseball caps with P&W emblem, $9,100. Check in the amount of $9,100. The notation is made: attach customer's emblems, Pratt & Whitney, 4,000 caps with no eggs, and some with gold scrambled eggs and some with silver scrambled eggs. Letter to Pratt & Whitney in the file says the above invoice was due for payment on January 23, 1982. "We would appreciate receiving your check by return mail. If this is not possible, a call from you letting us know when payment can be expected would help. Cordially yours, Maria Shoaf; Acct. Mgr."

Was that an item which was submitted for payment under overhead accounts?

Mr. Spanton. Yes, it was.

Mr. Dingell. Was that approved?

Mr. Spanton. Not by us.

Mr. Dingell. You did not recommend approval, but you don't know what the outcome was?

Mr. Spanton. That is right.

Mr. Dingell. We will refer to this as item 13, or exhibit 13, 3,500 P&W tie tacks, $8,886. That was submitted for payment as an overhead account item, is that correct?

Mr. Spanton. Yes, sir.

Mr. Dingell. Is that a proper expenditure of public monies for overhead accounts?

Mr. Spanton. No, sir.

Mr. Dingell. Did you recommend disapproval?

Mr. Spanton. Yes.

Mr. Dingell. Can you tell us what happened to that account?

Mr. Spanton. No.

Mr. Dingell. The next item, promotional items, apparently paper weights, $14,133. We will call this exhibit No. 14. Promotional items, apparently paper weights. F-100 with F-16 embedments. F-100 with F-15 embedments. TF-30 with F-111 embedment. TF-30 with F-14 embedment. A total of $7,292.65.

Then other items are included to bring the total to, as indicated, $14,133.

Was that submitted for enclosure in the compensation for overhead accounts?

Mr. **Spanton**. Yes, it was.

Mr. **Dingell**. Did you recommend approval or disapproval?

Mr. **Spanton**. Disapproval.

Mr. **Dingell**. Do you know what became of that recommendation?

Mr. **Spanton**. No, sir.

Mr. **Dingell**. Here we have an item of PGA Sheraton Resort of $43,672.91. A collection of different bills totaling $43,672.91: beverage reception, beverage dinner, dinner, hors d'oerves, luncheon, bartenders, should be charged $320, and a number of other items. Was that submitted for payment as a part of overhead accounts?

Mr. **Spanton**. This copy of mine is not coded, but if I recall, yes, this was part of the package. I don't see the code on here.

Mr. **Dingell**. Let me simplify this. Is this the kind of item that should be approved?

Mr. **Spanton**. It should not be allowed.

Mr. **Dingell**. It should not be allowed.

Mr. **Spanton**. I must assume that this was included with these other items as a claim. I must assume from the content of this voucher that it would be included as other similar PGA Sheraton vouchers as a claim that they would be claiming these costs.

Mr. **Dingell**. Here is an item of $813.70 for Thomas House, Ltd., corsages for Fighter Fling Ball. Is that a proper item for enclosure in overhead accounts?

Mr. **Spanton**. No, sir.

Mr. **Bryant**. Would the gentleman yield?

Mr. **Dingell**. I'd be happy to yield.

Mr. **Bryant**. Mr. Spanton, did I understand you correctly earlier to say that on each of these items that have been submitted, that you did not approve for payments, that there never will be a final judgment rendered on each one of them as to whether they are appropriate or not? But instead, the Government—or that is, the Defense Department will just settle all the claims it wants and pay a percentage?

Mr. **Spanton**. That is their procedure.

Mr. **Bryant**. So there never is any kind of a judgment on whether or not these hotel bills and golf ball bills, tie tacks and so forth, were appropriate to be submitted?

Mr. **Spanton**. Most often, what they do is make a percentage settlement, so they can't identify the individual items.

Mr. **Bryant**. Why do they do it that way?

Mr. **Spanton**. Because they want to negotiate and close out these contracts, and they find that a contractor has—the rules are all in his favor. He can out-wait procurement. And so they have to settle on his terms. They are pressured to settle these contracts, to close out these contracts, and what does he care. He's gotten progress payments. He might be ahead of the game just by sitting tight. So he can maintain a position.

Mr. **Bryant**. And he's already gotten his progress payments.

Mr. **Spanton**. Sure.

Mr. DINGELL. Let me pass over the balance of the entries in the file that I have been discussing, but I will observe they are items like Atlanta Athletic Club, Burt Reynolds Dinner Theatre, strolling musicians and other musicians, an item here for Executive Wives' Seminar, one for a staff party of $2,224, and one for a senior staff party in the amount of $2,280. Are those properly allowable overhead items?

Mr. SPANTON. Certainly not. Again, I consider these types of claims totally out of line.

Mr. DINGELL. Now we come down to an even more interesting set of devices. Here is one for a campaign fund, Jackie Winchester Campaign Fund, $250. Attached is a memorandum with regard to potential campaign contributions, justification therefor and so forth, including amounts, and names, property appraiser, Florida Senate, Florida House of Representatives, state attorney sheriff property appraiser, supervisor of elections, county commission and school board.

Are those items which should properly be included in overhead account items?

Mr. SPANTON. No; they should not. We questioned it.

Mr. DINGELL. Can you tell me when this item was questioned?

Mr. SPANTON. Well at the time that we did the audit, which would be during that 1981-82 timeframe——

Mr. DINGELL. The 1981-82 timeframe?

Mr. SPANTON. Yes.

Mr. DINGELL. That was questioned at that point?

Mr. SPANTON. When you say questioned—we didn't issue the report. We pulled it out, we indicated in our workpapers that these items will not be reinstated but these are part of the items of the total package being reviewed by the Federal Bureau of Investigation. And so until their efforts concluded, all of these expenditures are on hold.

Mr. DINGELL. All of these expenditures? The political contributions to the Lewis campaign fund, Liberti campaign fund, looks like Wille campaign fund, Winchester campaign fund, Bailey campaign fund, Neesmith campaign fund.

And here is an item for promotional items for balloons, $1,176. Was that submitted as an overhead item?

Mr. SPANTON. Yes.

Mr. DINGELL. Was it approved?

Mr. SPANTON. No.

Mr. DINGELL. Did you recommend against it?

Mr. SPANTON. Yes.

Mr. DINGELL. Item of dinner dance, $1,200, check accompanying it. Air Force Association. Is that a proper item for inclusion in overhead?

Mr. SPANTON. No.

Mr. DINGELL. It is not. Did you recommend against its approval?

Mr. SPANTON. Yes.

Mr. DINGELL. I have here expenses at The Breakers, $2,133, room charge. Guest: Mr. & Mrs. Roberto De La Rocha, Pratt & Whitney. Is that a proper item for inclusion in overhead?

Mr. SPANTON. I have lost that one, Mr. Chairman, but I can tell you on the surface of it, no, without looking at it.

Mr. **Dingell.** Here is an item, "Banquet at The Breakers" $3,800. Another item, banquet at The Breakers, $16,433, immediately following the earlier item of expenditures. Is that a proper item for inclusion in the overhead account payments?

Mr. **Spanton.** I recall on one or two of these Breaker invoices—and I don't have the one in front of me that you are alluding to—it might have been claimed that this was for employee morale or they hold some 25-year—but they do it up big. And we questioned all of it or a good portion of it as being unreasonable.

Mr. **Dingell.** Without objection, the Chair will insert all of these into the record. And if you choose to make any additional comments with regard to them, I believe it will be of value to the committee and to our inquiries.

[Testimony resumes on p. 252.]

[A letter from United Technologies and the documents referred to follow:]

UNITED
TECHNOLOGIES

Suite 700
1825 Eye Street, N.W.
Washington, D.C. [illegible]
202-785-7400 785-7416

Clark MacGregor
Senior Vice President

POWER
Pratt & Whitney
[illegible]
Power Systems
[illegible]
BUILDING SYSTEMS
Otis Elevator
Carrier Air Conditioning
Building Automation
ELECTRONICS
[illegible]
Essex
Automotive
Hamilton Standard
Norden Systems
Microelectronics Center
[illegible]
[illegible]
RESEARCH CENTER

8:00 a.m.
23 April 1985

The Honorable John D. Dingell
Chairman, Committee on
Energy and Commerce
U. S. House of Representatives
Washington, D.C. 20515

Re: Today's P&W Hearings

Dear Mr. Chairman:

The 1980 Florida state political campaign contributions, proper under Florida law, should never have been included in allowable costs.

This claim, inadvertently made, was withdrawn in August 1983. No part of it has been paid.

This matter first came to my attention yesterday afternoon. An internal investigation is going forward to determine what disciplinary action may be appropriate.

Sincerely yours,

Clark MacGregor

Clark MacGregor

cc: The Honorable James T. Broyhill
The Honorable Michael Bilirakis

[illegible] Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box [illegible], West Palm Beach, Florida [illegible] Phone [illegible]

KING DAVID HOTEL JERUSALEM	[illegible]	[illegible]

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
[illegible]

JAN 28 [illegible]

96951

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

[illegible]	1-21-[illegible]	[illegible]

$[illegible]

TO THE ORDER OF

KING DAVID HOTEL JERUSALEM

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

BEST COPY AVAILABLE

CHECK REQUEST FORM

TO: Charlie Feeley /

FROM: Ernie Wright/Joe Jaswinski EXT. 3488

DATE: 1/18/82

* * *

Would you please request a check as follows:

AMOUNT: $3,231.00

ISSUED TO: King David Hotel Jerusalem

FOR: [illegible] Dinner function in Israel. Expense associated with customer business discussions concerning proposed changes in government acquisition policy.

Dep. 875-32,787.1

CHARGE TO: DEPT. NO. 130-5 483.86/ ACCT. NO. 7490

Please return this check to Customer Relations (A83) for transmittal.

APPROVED

802-5

Room No.	Surname	Occ	Pers.	Rate	Group
[illegible]	[illegible]	[illegible]			

Country	First Name	In	Time

CONTINUATION / DEPOSIT BILL 36 011670

67350

REMARKS	ROW	DETAILS
Food + Beverage	1	[illegible] 373.00
etc.	2	[illegible] 373.00 16
PRATT, [illegible]	3	
[illegible] GROUP	4	
	5	
	6	
[illegible] 3691	7	[illegible] 373.00 16
[illegible]	8	[illegible]
[illegible]	9	[illegible]
	10	
[illegible]	11	
	12	[illegible]
	13	[illegible]
	14	[illegible] $463.86
	15	
	16	
	17	[illegible]
	18	[illegible]
	19	[illegible]
CIGARET	20	[illegible]
	21	[illegible] 1700.00
	22	[illegible]
	23	[illegible]
	24	[illegible]
	25	[illegible]
	26	[illegible]
	27	[illegible]
	28	TALLY 2767.14
	29	$ 3231.—

For all Communications

Please refer to our

Reference:

DATE

RATE CHANGE

THANK YOU AND SHALOM

36 011670

PRATT & WHITNEY AIRCRAFT GROUP

00831

11-03-81

FLORIDA GOLF & TENNIS
[illegible] BLVD.
NORTH PALM BEACH, FL 33408

NOT NEGOTIABLE

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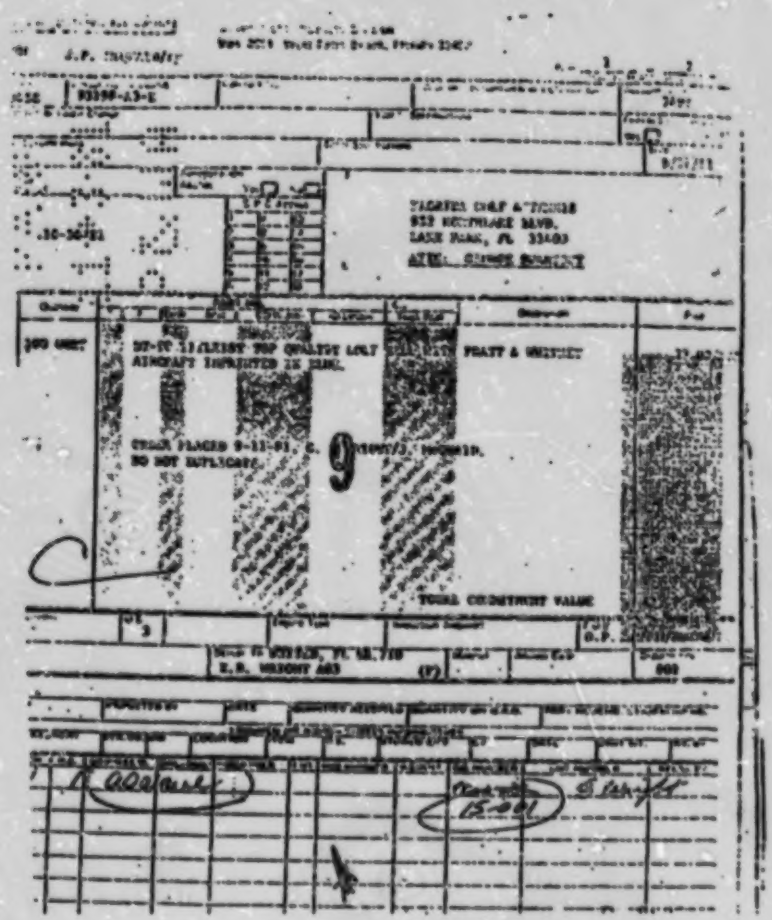

J.P. [illegible]

[illegible]-A3-E

9/21/81

.10-30/81

TAGRTEA GOLF & TENNIS
932 NORTHLAKE BLVD.
LAKE PARK, FL 33403
ATTN: [illegible]

300 UNIT [redacted]

DT-TC 11/LXIDST TOP QUALITY GOLF [redacted] PRATT & WHITNEY
AIRCRAFT INSPECTED IN PLANT.

ORDER PLACED 9-11-81, C. [illegible], [illegible].
DO NOT DUPLICATE.

9

TOTAL CONTRACT VALUE [redacted]

O.P. [illegible]

E.B. WRIGHT AGS (P)

000

15-001

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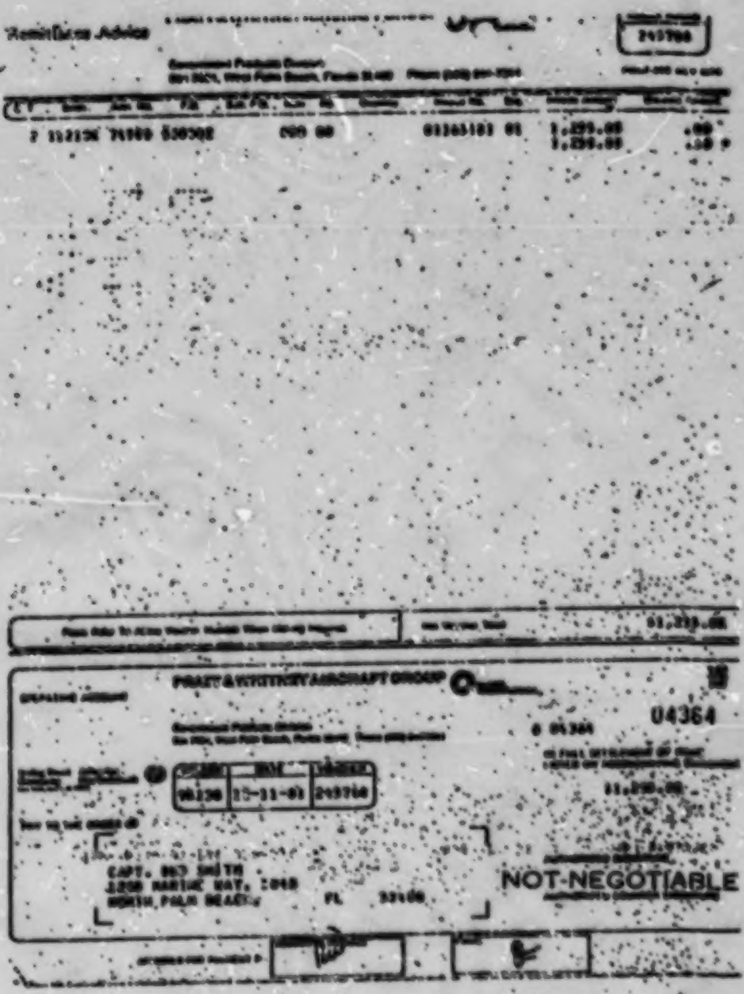

Remittance Advice

[illegible]

7 112136 71980 530302 000 00 01365101 01 [illegible] .00

[illegible] .00 P

PRATT & WHITNEY AIRCRAFT GROUP

04364

12-11-81

CAPT. [illegible] SMITH

[illegible]

NORTH PALM BEACH FL [illegible]

NOT-NEGOTIABLE

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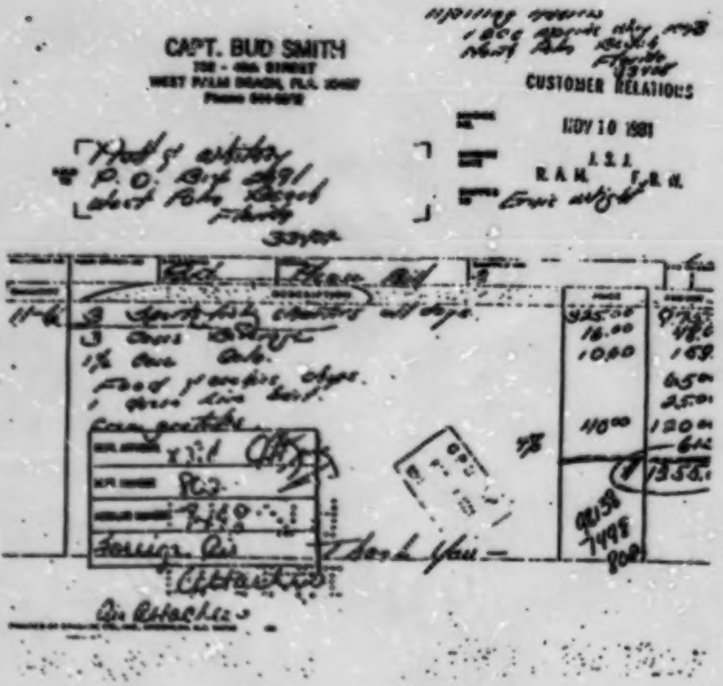

CAPT. BUD SMITH
[illegible]
WEST PALM BEACH, FLA. [illegible]
Phone [illegible]

[illegible]
P. O. Box [illegible]91
West Palm Beach
Florida
33[illegible]

[illegible]
[illegible]
West Palm Beach
Florida
33[illegible]

CUSTOMER RELATIONS
NOV 10 1981
J. S. J.
R. A. M.
F. R. M.

11-6	3 [illegible] charters all days	325.00	975.[illegible]
	3 [illegible]	16.00	48.[illegible]
	1½ [illegible]	10.00	15.[illegible]
	Food [illegible]		65.[illegible]
	1 [illegible]		25.[illegible]
	[illegible]	110.00	120.[illegible]
			61.[illegible]
			1355.[illegible]

Thank You —

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BUSINESS GUEST REPORT DOCUMENTATION

DATE	NAME	TITLE	AFFILIATION	BUSINESS TOPIC
11/6	*BOAT 1			
	Bob Frazier		GPO	Air Attaches
	Sjoergo Hansen		(Norway)	
	Martinez Lacaci		(Spain)	
	Von Rafelghem		(Belgium)	
	John Harding		PBMA- Wash.	
	Mr. Schwab		PBMA	
	*BOAT 2			
	Mr. Withers		PSVA	
	Vosiniotis		(Greece)	
	Weller		(Australia)	
	Keown		(New Zealand)	
	Hall		(Great Britain	
	*BOAT 3			
	[illegible]		[illegible]	
	[illegible]		PBMA Canada	
	Eller,		GAC	
	[illegible]		PDC	
	Ben Peretz		(Israel)	

802-6

132

emittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

Voucher Number
237929

T	[illegible]	Acct. No.	P.O.	Sub. P.O.	Item	RC	Quantity	Invoice No.	Seq.	Invoice Amount	Discount Amount
2	109048	74988	000002		000	00		04183424	01	1,844.44	.00
										1,844.44	.00 *

6

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $1,844.44

PRATT & WHITNEY AIRCRAFT GROUP

OPERATING ACCOUNT

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

85730

D. 85730

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
98530	09-08-81	237929

$1,844.44

PAY TO THE ORDER OF

Callaway Gardens

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

BEST COPY AVAILABLE

Pine Mountain, Georgia 31822

404 - ATLANTA. 688-8542
404 - COLUMBUS 324-2234

STATEMENT OF PURPOSE CALLAWAY GARDENS IS OWNED AND OPERATED BY THE IDA CASON CALLAWAY FOUNDATION, A NON PROFIT EDUCATIONAL, SCIENTIFIC, RELIGIOUS AND CHARITABLE ORGANIZATION. ITS WHOLLY OWNED TAX-PAYING SUBSIDIARY, GARDENS SERVICES, INC., A REGULAR BUSINESS CORPORATION, OPERATES THE RECREATIONAL, LODGING AND RETAIL FACILITIES AT CALLAWAY GARDENS

Gardens Services, In
Pine Mountain
Georgia 31822

PRATT & WHITNEY
RAY VAN OVERSCHELDE
P.O. BOX 2691 A-83
WEST PALM BEACH, FL. 3

CUSTOMER RELATIONS
AUG 25 1981

MO. DAY YEAR
08-17-81
A 163424
ACCOUNT NO.

08-17-81

A 163424
Please Write This Account N
On The Face of Your Che

BALANCE DUE UPON RECEIPT

M.L.H. J.S.J.
F.R.W. R.L.W.

SEND INQUIRIES TO: CALLAWAY GARDENS
ACCTG. DEPT. - A/REC.
PINE MOUNTAIN, GA. 31822

PLEASE DETACH THIS ST
AND RETURN WITH PAY

DATE	DESCRIPTION AND REFERENCE	CHARGES	CREDITS	BALANCE
08-09-81	ROOM CHARGES	197.60	MISSIMER	197.60
08-09-81	ROOM CHARGES	124.80	MISSIMER	322.40
08-09-81	ROOM CHARGES	172.61	OVERSCHELD	495.01
08-09-81	ROOM CHARGES	263.14	OVERSCHELD	758.15
08-09-81	ROOM CHARGES	197.60	OVEREND	955.75
08-09-81	ROOM CHARGES	124.80	OVEREND	1,080.55
08-09-81	ROOM CHARGES	197.60	PELLBACH	1,278.15
08-09-81	ROOM CHARGES	124.80	PELLACH	1,402.95
08-11-81	GARDENS REST.	31.20	PRAT04095	1,434.15
08-11-81	[redacted]	147.20	PRAT04095	[redacted]
08-11-81	[redacted]	75.89	PRAT04095	[redacted]
08-11-81	[redacted]	93.60	PRAT04095	[redacted]
08-11-81	[redacted]	93.60	PRAT04095	[redacted]

DEPT. APPROVAL	x
DEPT. NUMBER	816
ACCOUNT NUMBER	7498

98538

STATEMENT - PLEASE PAY THIS AMOUNT

1,844.44	1,844.44
BALANCE DUE	BALANCE DUE

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Callaway Gardens
Pine Mountain, Georgia 31822

NO.

DIVISION L. V.

SOLD TO: Van Overschelde
ADDRESS (Pratl + Whitney)
F/B 6316 NT8

DATE OF ORDER 8/9/81

NO.	UNIT	DESCRIPTION	UNIT PRICE	TOTAL
4		GREEN FEES	15.00	60.00
2		POWER CARTS	15.00	30.00
		SKY VIEW		
		HAND CARTS		90.00
		RENTAL CLUBS		3.60
		MERCHANDISE		
				93.60

Mr R. VanOverschelde

Callaway Gardens
Pine Mountain, Georgia 31822

NO.

DIVISION LV

SOLD TO: Pratt + Whitney
ADDRESS
M/B 6316

6/5/81

NO.	UNIT	DESCRIPTION	UNIT PRICE	TOTAL
8		GREEN FEES	15.00	12
4		POWER CARTS	15.00	6
		SKY VIEW		18
		HAND CARTS	[illegible]	7
		RENTAL CLUBS		$187
		MERCHANDISE		

R VanOverschelde

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[illegible] NO.

Callaway Gardens
Pine Mountain, Georgia 31822

Phones
Pine Mountain, Ga. [illegible]
Columbus, Ga. [illegible]
Atlanta, Ga. [illegible]

VISION MIV

OLD TO:

DDRESS Pratt + Whitney

63;6

[illegible] 8/9/81

R Van Overschelde

UNIT	DESCRIPTION	UNIT PRICE	TOTAL
1	GREEN FEES		60.00
7	POWER CARTS		30.00
	SKY VIEW		90.00
	HAND CARTS		
	RENTAL CLUBS	12	5.60
	MERCHANDISE		
			75.60

GARDENS RESTAURANT GUEST CHECK

[illegible]	[illegible]	SERVER	DATE	GUEST CHECK NO
2	8		8/9	37334

8 Salad Bar	30	00
6316		
SUB-TOTAL		
SERVICE CHG.		
SUB-TOTAL		
GA. SALES TAX	1	20
TOTAL	31	20

GROUP NAME FOR MASTER BILLING
PRATT & WHITNEY

SIGNATURE R Van Overschelde

ROOM NO. N18

Callaway Gardens
Pine Mountain, Georgia 31822

DATE	TOTAL AMOUNT OF CHECK
ROOM NO.	37334

NO.

Callaway Gardens
Pine Mountain, Georgia 31822

DIVISION ____________

SOLD TO: Pratt & Whitney

ADDRESS 6316

NO.	QTY	DESCRIPTION	UNIT PRICE	TOTAL
		GREEN FEES		
		POWER CARTS		30 00
		SKY VIEW		
		HAND CARTS		
		RENTAL CLUBS		
		MERCHANDISE		
				170
				3 70
		Balls		4 50
				1 9

137

N 2589

BUSINESS GUEST REPORT DOCUMENTATION

DATE	NAME	TITLE	AFFILIATION	BUSINESS TOPIC
8/9/81	Mr. & Mrs. Missimer		GPD	Advanced Systems and
	Mr. & Mrs. Van Overschelde		GPD	International Marketir
	Mr. & Mrs. Overend		Grumman	
	Mr. & Mrs. Polehach		Grumman	

302-6

7

111236 74690 000001	000 00	00045556 01	516.00	.00
			516.00	.00
111236 74908 072650	001 00	00007976 01	5,190.00	.00
			5,190.00	.00
111235 74878 072180	001 00	00007821 01	3,232.00	
			3,232.00	
111236 74506 072625	001 00	00007952 01	3,547.92	.00
			3,547.92	.00
111236 74910 072647	001 00	00007952 01	13,761.00	.00
111236 74650 000001	000 00	02	516.00	.00
			14,277.00	.00
111236 74950 072697	001 00	00000156 01	7,931.00	.00
111236 74650 000001	000 00	02	120.77	.00
			8,051.77	.00

$ 12652

Please Refer To Above Voucher Number When Making Inquiries | Net Voucher Total | $34,965.69

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division

02993

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
94671	11-24-81	244389

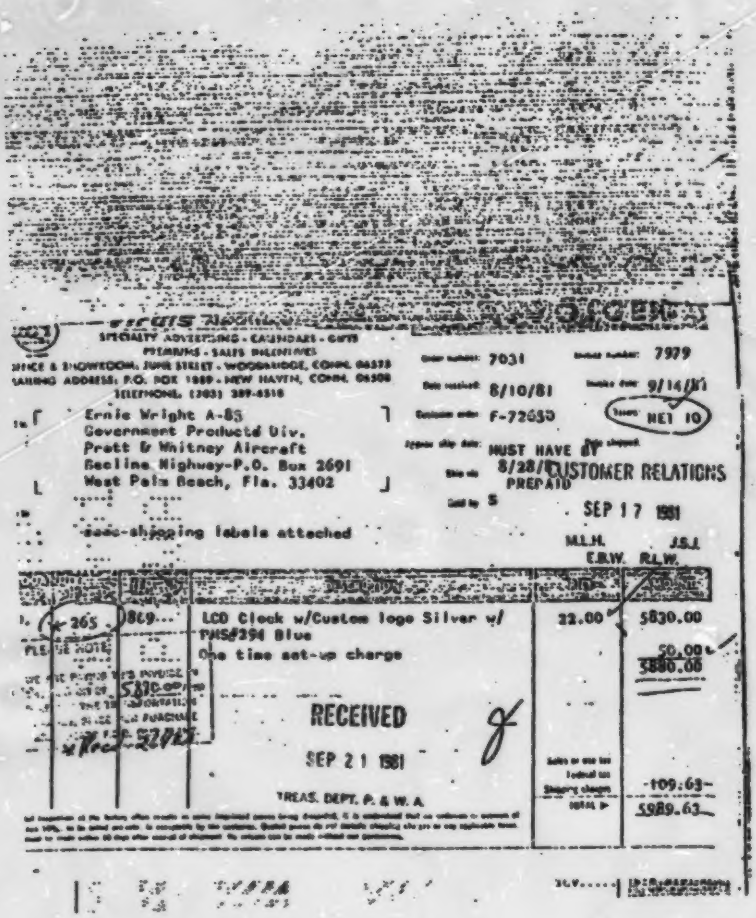
$34,965.69
27,322
7,643.69

THE ORDER OF

VIRDIS ASSOCIATES, INC.
P. O. BOX 3089
NEW HAVEN, CT 06508

AUTHORIZED SIGNATURE
NOT-NEGOTIABLE
AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT



[illegible]

SPECIALTY ADVERTISING - CALENDARS - GIFTS
PREMIUMS - SALES INCENTIVES
FFICE & SHOWROOM, JUNE STREET - WOODBRIDGE, CONN. 06525
AILING ADDRESS, P.O. BOX 1989 - NEW HAVEN, CONN. 06508
TELEPHONE, (203) 389-6510

Ernie Wright A-85
Government Producte Div.
Pratt & Whitney Aircraft
Beeline Highway-P.O. Box 2691
West Palm Beach, Fla. 33402

Order number: 7031
Invoice number: 7979
Date received: 8/10/81
Invoice date: 9/14/81
Customer order: F-72650
Terms: NET 10
Approx. ship date: MUST HAVE BY 8/28/81
Date shipped:
Ship via: PREPAID
Sold by: S

CUSTOMER RELATIONS
SEP 17 1981
M.L.H. J.S.J.
E.B.W. R.L.W.

shipping labels attached

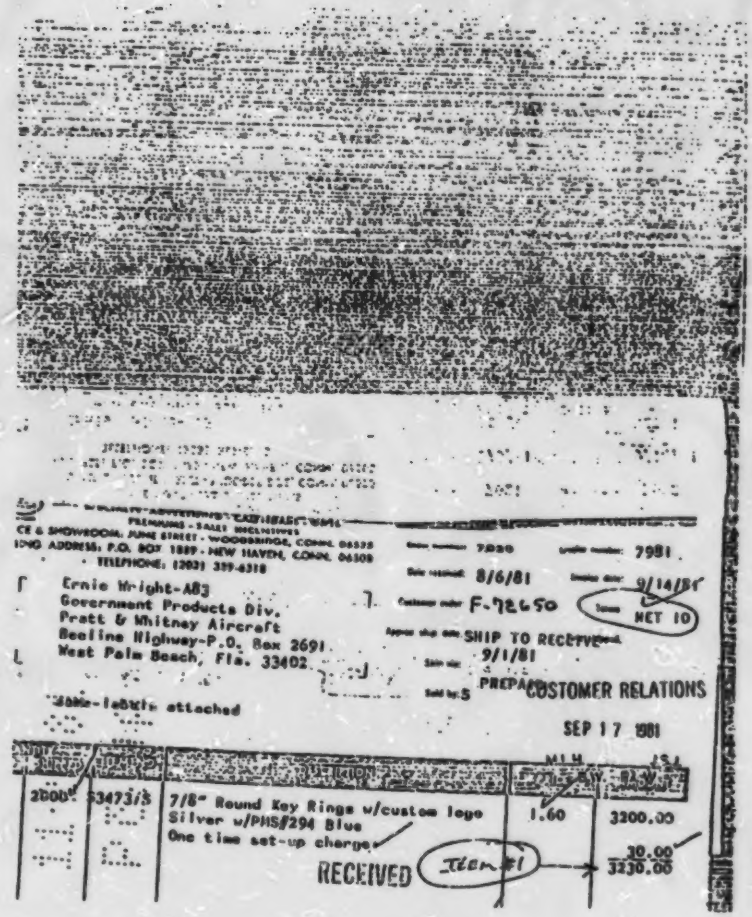
265	869...	LCD Clock w/Custom logo Silver w/ PMS#294 Blue	22.00	5830.00
		One time set-up charge		50.00
				5880.00
			Shipping charges	109.63
			TOTAL ▶	5989.63

PLEASE NOTE: [illegible] THIS INVOICE [illegible] 5830.00 [illegible] PURCHASE [illegible]

*Rec [illegible]

RECEIVED
SEP 21 1981
TREAS. DEPT. P. & W. A.

[illegible]



PREMIUMS - SALES INCENTIVES
CE & SHOWROOM, JUNE STREET - WOODBRIDGE, CONN. 06525
ING ADDRESS: P.O. BOX 1889 - NEW HAVEN, CONN. 06508
TELEPHONE: (203) 389-6318

Ernie Wright-AB3
Government Products Div.
Pratt & Whitney Aircraft
Beeline Highway-P.O. Box 2691
West Palm Beach, Fla. 33402

7020
7981
8/6/81
9/14/81
F-72650
NET 10
SHIP TO RECEIVE
9/1/81
S
PREPAID

CUSTOMER RELATIONS
SEP 17 1981

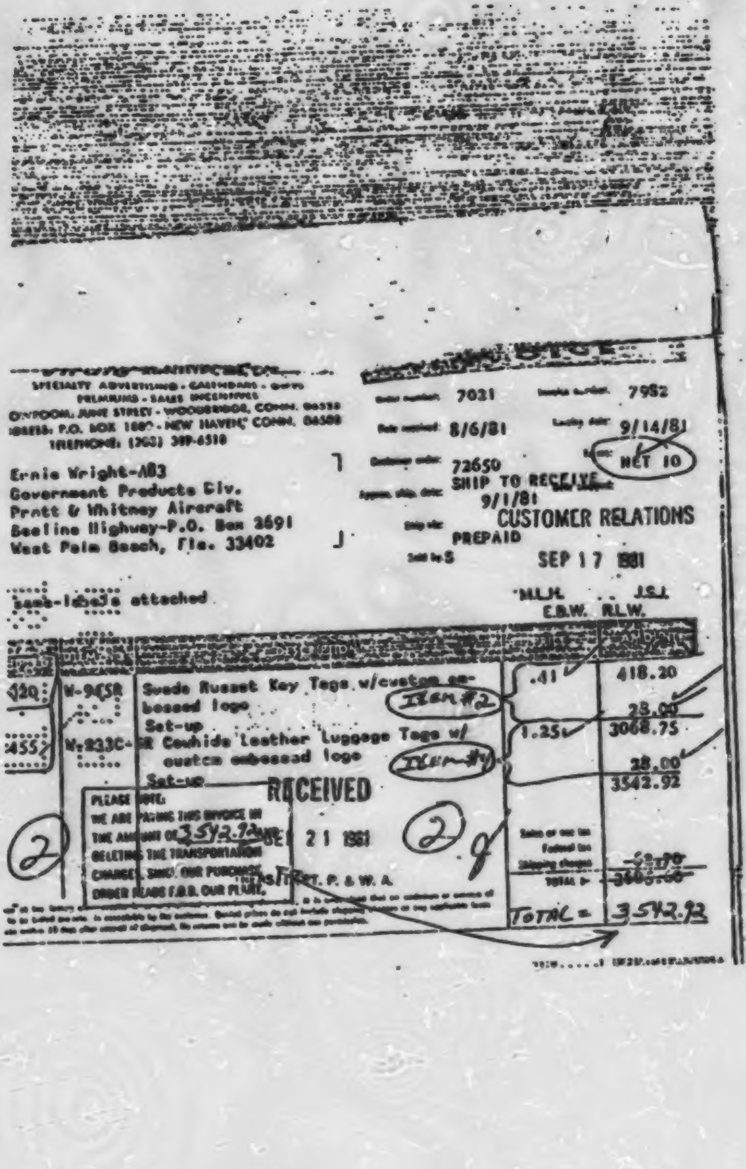
[illegible]-labels attached

MLH JSL

2000	53473/S	7/8" Round Key Rings w/custom logo Silver w/PMS#294 Blue One time set-up charge	1.60	3200.00 30.00 3230.00

RECEIVED

Item #1



[illegible]

SPECIALTY ADVERTISING - CALENDARS - GIFTS
PREMIUMS - SALES INCENTIVES
SHOWROOM: JUNE STREET - WOODBRIDGE, CONN. 06525
ADDRESS: P.O. BOX 1887 - NEW HAVEN, CONN. 06508
TELEPHONE: (203) 389-6510

Ernie Wright-A83
Government Products Div.
Pratt & Whitney Aircraft
Beeline Highway-P.O. Box 2691
West Palm Beach, Fla. 33402

Order number	7021
Invoice number	7982
Date received	8/6/81
Invoice date	9/14/81
Terms	NET 10
Customer order	72650
	SHIP TO RECEIVE
Approx. ship date	9/1/81
Ship via	PREPAID
Sold by	S

CUSTOMER RELATIONS
SEP 17 1981
M.L.H. J.S.J.
E.B.W. R.L.W.

same-labels attached

120	W-96SR	Suede Russet Key Tags w/custom embossed logo	.41	418.20
		Set-up		28.00
2455	W-833C-SR	Cowhide Leather Luggage Tags w/ custom embossed logo	1.25	3068.75
		Set-up		28.00
				3542.92
			Sales or use tax Federal tax Shipping charges	~~63.70~~
			TOTAL ▶	~~[illegible]~~
			TOTAL =	3542.92

Item #2

Item #4

②

②

PLEASE NOTE:
WE ARE PAYING THIS INVOICE IN
THE AMOUNT OF 3542.92 AND
DELETING THE TRANSPORTATION
CHARGES, SINCE OUR PURCHASE
ORDER READS F.O.B. OUR PLANT.

RECEIVED
OCT 21 1981
[illegible] P. & W. A.

[illegible]

Remittance Advice

PRATT & WHITNEY AI...CRAFT GRO.

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

Loc 10673.

Voucher Number
92919

PWAF-[illegible] REV [illegible]

[illegible]	Quantity	Invoice No.	Date	Invoice Amount	Discount Amount
[illegible]		4900		07853.31	

8

Please Refer To Above Voucher Number While Making Inquiries

Net Voucher Total 07853.31

OPERATING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

MAR 6 1981

92919

VENDOR	DATE	VOUCHER
9082	3-4-81	92919

IN FULL SETTLEMENT OF ITEMS
LISTED ON ACCOMPANYING STATEMENT

$7,853.31

PAY TO THE ORDER OF

[illegible]

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

CHECK REQUEST FORM

TO: Charlie Feeley R83 /

FROM: Ernie Wright EXT. 2428

DATE: 2/19/81

* * *

Would you please request a check as follows:

AMOUNT: Queensway Hilton

ISSUED TO: $7,853.51

FOR: CX-Douglas Cocktail Reception

GPD A/P
[illegible]
ENT.

CHARGE TO: DEPT. NO. 100 / ACCT. NO. 7498

Please return this check to Customer Relations (A83) for transmittal.

98954
7498
100

Ernest B. Wright

APPROVED E Bellak

802-5

From: Customer Relations

To: Charlie Feeley Date: 3-2-81

Per your request.
You have check request.

Marlene
x2436

PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

BANQUET

DATE 2 - 3 19 [illegible]

NAME Pratt - Whitney Air ROOM OR ACCT. NO. [illegible]

DATE SYMBOL AMOUNT

FEB -3 [illegible] B * 330.00

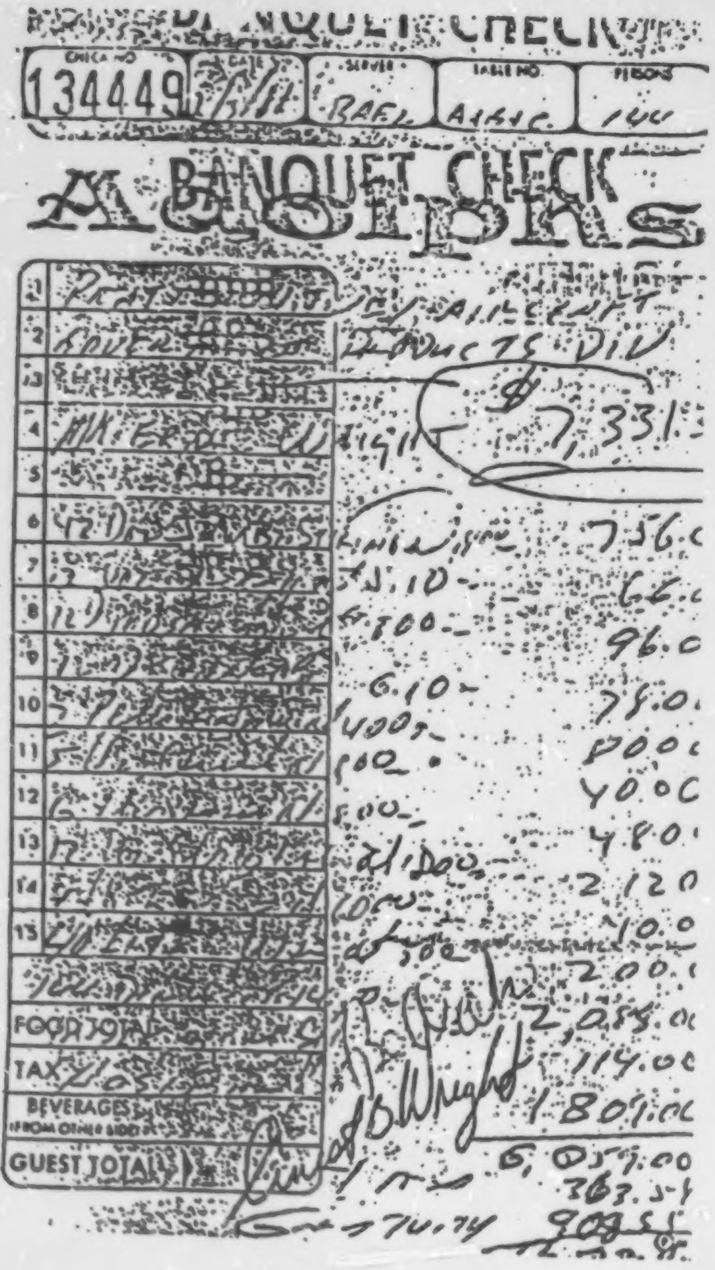
DO NOT WRITE IN ABOVE SPACE

EXPLANATION ICE CARVING	225	00
2 BARTENDER CHARGE 35.00 EA	70	00
1 COCKTAIL WAITRESS	35	00
	330	00

CENTURY
FORM NO. C2

SIGNED BY G. [illegible]

BEST COPY AVAILABLE



BANQUET CHECK

CHECK NO. 134449 | DATE [illegible] | SERVER BAFL | TABLE NO. A[illegible] | PERSONS 144

BANQUET CHECK

[illegible] AIRCRAFT PRODUCTS DIV

$7,331.

1	[illegible]	
2	[illegible]	
3	[illegible]	
4	[illegible]	
5	[illegible]	
6	(121) [illegible]	756.0
7	[illegible] .10	66.0
8	(12) [illegible] 800	96.0
9	[illegible] 6.10	78.0
10	[illegible] 400	800.0
11	[illegible] 800	400.0
12	[illegible] 800	480.0
13	[illegible] 21.00	2,120
14	[illegible] 10.00	10.0
15	[illegible]	200.0
	[illegible]	
FOOD TOTAL		2,085.00
TAX		114.00
BEVERAGES (FROM OTHER SIDE)		1,809.00
GUEST TOTAL		6,057.00
		363.54
	74.74	90[illegible]

J D Wright

BEST COPY AVAILABLE

[illegible]

Queensway Bay Hilton

FOLIO NO: 7243

1119 DATE

GUEST: PRATT WHITNEY AIRCRAFT

PHONE NO.

CLERK

					B* .00
FEB-26 MISC			B*330.00		
FEB-26	TS	7243	B* 37.36	* 367.36	C* 367.36
FEB-26	BB		C7,331.39	* 7,698.75	

2-26-81

DEPT. APPROVAL	x
DEPT. NUMBER	100
ACCOUNT NUMBER	7498

CX-Douglas

Cocktail Reception

GUEST'S SIGNATURE ____________

CHARGE TO ____________

ADDRESS ____________

ACCOUNT IS DUE AND PAYABLE UPON PRESENTATION. AFTER 30 DAYS, THERE IS A 1 1/2% FINANCE CHARGE WHICH IS AN ANNUAL RATE OF 18%.

BEST COPY AVAILABLE

ROOM: 305

Queensway Bay Hilton

[illegible]

1119

FOLIO NO: 3889

DATE: 3.14

2/73

GUEST: Coar, D

DWA

PHONE NO.

CLERK: JT

				C*	.0[illegible]
FEB-36	ROOM	305	C*	73.00	
FEB-36	TAX	305	C*	4.37	
FEB-36	TAX	305	C*	.01	* 77.38 *

DEPT. APPROVAL x [illegible]

DEPT. NUMBER 100

ACCOUNT NUMBER 7498

CV - Douglas

Cocktail Reception

Ernest B Wright

GUEST'S SIGNATURE:

CHARGE TO DWA

ADDRESS 4818 Lincoln Blvd #212
Marina Del Rey Ca. 90291

[illegible]

BEST COPY AVAILABLE

ROOM
452

Queensway Bay Hilton

FOLIO NO: 5867

1119

DATE: 2 4
2/78

GUEST: Mc Abee, F.

PWA

PHONE NO.

CLERK: JT

			C* .00		
FEB-24	ROOM	452	C* 73.00		77.38 *
FEB-24	TAX	452	C* 4.38		

X

DEPT. APPROVAL

DEPT. NUMBER 100

ACCOUNT NUMBER 7498

Cit Douglas

Cocktail Reception

GUEST'S SIGNATURE

CHARGE TO PWA

ADDRESS 4878 Lincoln Blvd. #2/2
Marina Del Rey, Ca. 90291

ACCOUNT IS DUE AND PAYABLE UPON PRESENTATION ... FINANCE CHARGE ... RATE OF 18%

BEST COPY AVAILABLE

CHECK REQUEST FORM

TO: Charlie Feeley A83 /

FROM: Ernie Wright EXT. 2428

DATE: 2/18/91

* * *

Would you please request a check as follows:

AMOUNT: Queensway Hilton

ISSUED TO: $7,353.51

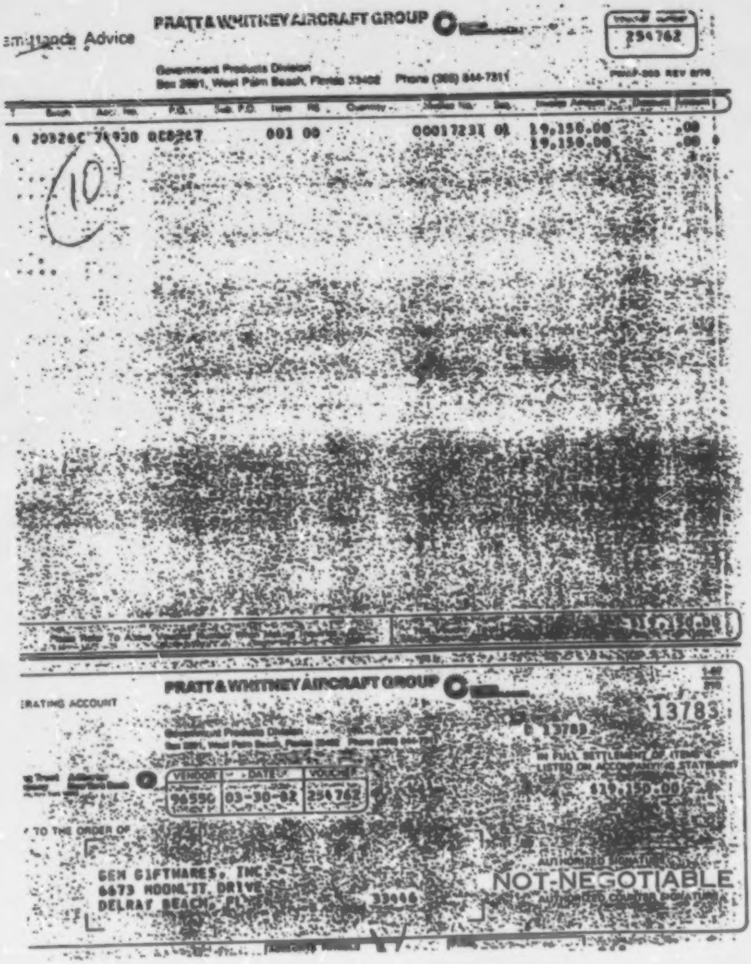
FOR: CA-Douglas Cocktail Reception

CHARGE TO: DEPT. NO. 100 / ACCT. NO. 7498

Please return this check to Customer Relations (A83) for transmittal.

802-5

APPROVED



Remittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

Voucher Number
254762

T	Batch	Acct. No.	P.O.	Sub P.O.	Item	Rl.	Quantity	Invoice No.	Seq.	Invoice Amount	Discount	Amount
9	20326C	74930	0E8267		001	00		00017231	01	19,150.00	.00	
										19,150.00	.00	

⑩

Please Refer To Above Voucher Number [illegible]

$19,150.00

PRATT & WHITNEY AIRCRAFT GROUP

RATING ACCOUNT

Government Products Division

13783

No 13783

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
96556	03-30-82	254762

$19,150.00

TO THE ORDER OF

GEM GIFTWARES, INC
6673 MOONLIT DRIVE
DELRAY BEACH, FL 33446

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

BEST COPY AVAILABLE

GEM GIFTWARES, INC. ✓

INVOICE

ORIGINAL COPY

12-24 PINE STREET, SWAMPSCOTT, MASS. 01907
TEL. (617) 596-7780 • TOLL FREE (800) 225-2844 • TELEX 94-0437
GEMLINE CREATIONS - ASI 5807

SOLD TO:
PRATT & WHITNEY AIRCRAFT
GOVERNMENT PROD. DIV.
BEE LINE HIGHWAY A-43
WEST PALM BEACH, FL.
33402

SHIP TO:
PRATT & WHITNEY AIRCRAFT
GOVERNMENT PROD. DIV.
BEE LINE HIGHWAY A-43
WEST PALM BEACH, FL.
33402

THIS INVOICE NUMBER MUST APPEAR ON YOUR PAYMENT.

COUNT UMBER	ORDER DATE	CUSTOMER ORDER NUMBER	SALES-MAN	TERMS	SHIP VIA	INVOICE DATE	INVOICE NUMBER
1706	12/15/8.	F085367	4	NET 30 ✓	UPS	02/23/82	17231

RED	QUANTITY SHIPPED	BAL.	PRODUCT NO.	COLOR	DESCRIPTION	UNIT PRICE	DISC. %	AMOUNT
1000	1000 ✓		9999	MISC	0S30917 P & W EMBLEMS	1.90 ✓		1,900.00
250	250 ✓		9999	MISC	#2502 CLASSIC BLACK BALL PENS	11.00 ✓		2,750.00
250	250 ✓		9999	MISC	#3002 STERLING SLVR BALL PENS	26.00 ✓		6,500.00
500	500 ✓		9999	MISC	#4502 10KT. G.F. PENS	16.00 ✓		8,000.00
						SUBTOTAL		19,130.00
						TOTAL		19,130.00

RECEIVED
MAR 11 1982
TREASURY DEPT., PWA

****
THANK YOU FOR YOUR ORDER!
****

[illegible]

F SS307

NO SUBSTITUTE FOR QUALITY

Government Products Division
Box 2591 West Palm Beach, Florida 33402

Page 1 of 1

J. P. McQuaid/jra

000470	S-96550-A3-E-A	Contract No.	W.O. or Appropriation or CLIN No.	7498
			Date	1/8/82

1st 2/16/82

Yes ☐ No ☐

Gem Giftwares, Inc.
6673 Moonlit Drive
Delray Beach, FL 33446
Attn: Ted Isaacson

Item	Quantity	PART NO.	Description	Price
1	250 ea	[redacted]	Cross cla[redacted] pens	11.00/e
2	250 ea	[redacted]	Cross ser[redacted]ver pens	26.00/e
3	500 ea	[redacted]	Cross 10K gold pens	[redacted]
4	1000 ea	[redacted]	P&WA emblems attached	[redacted]

Telephone order placed [redacted] phone 12/1[redacted] Ted Isaacson. Do not duplicate.

Note: 10% overshipment allow[redacted] over that will be returned freight collect.

Do Not Overship

9

[redacted] Commitment Value

.3

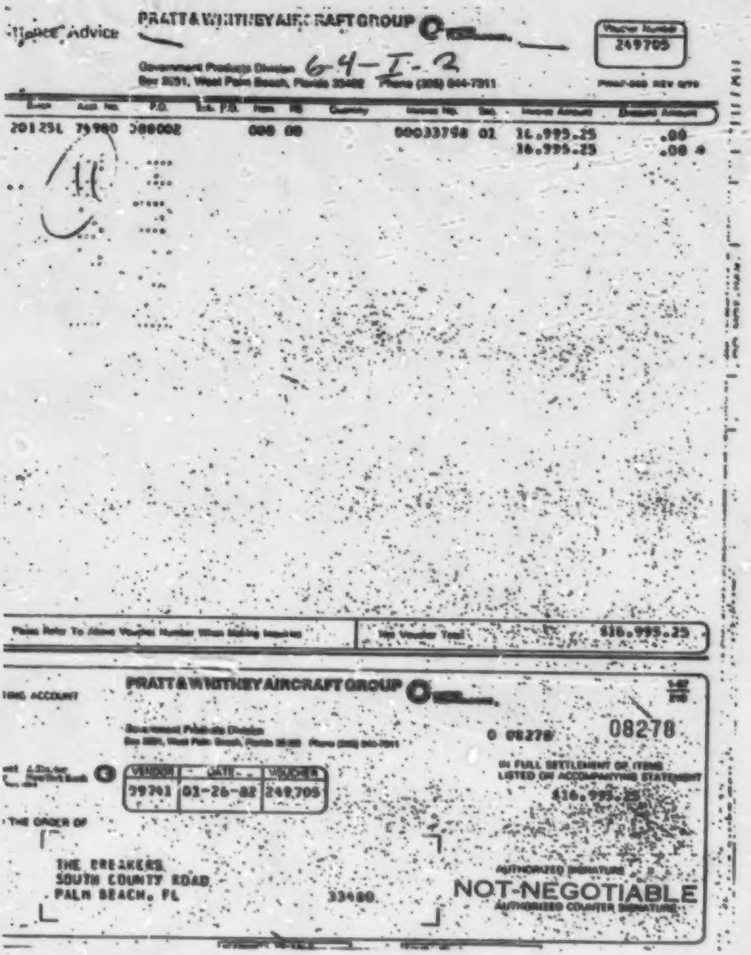
Deliver to United, FL SR710 33402
Ernest B. Wright (F)

802

PS

DATE	ITEM		QTY REC'D.	BAL. DUE	CARRIER	FRT	W/B NUMBER	WEIGHT	P/S NUMBER	LOT NUMBER	
2/82	2	6	HC HP1	U7	C-line	P	57253	300	P/S	11-148-6-F	

F SS307



[illegible] Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division 6-4-I-2
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

Voucher Number
249705

[illegible] REV [illegible]

[illegible]	[illegible]	P.O.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Invoice Amount	Discount Amount
201256	79980	388002		008	00		00033798	01	16,995.25	.00
									16,995.25	.00 *

11

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $16,995.25

[illegible] ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

0 08278 08278

VENDOR	DATE	VOUCHER
79741	02-26-82	249,705

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

$16,995.25

THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

BLANK PAGE

BLANK PAGE

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REPAIR AND MAINTENANCE

DEPT. CODE 80-90

№ 1090

CREDIT 165-8210 5.00

CHARGE

ROOM OR A/C NO. 3 3 7 9 8

ID P R

☒ GUEST
☐ CITY LEDGER

DATE 12 / 18 / 81

PRINT NAME CLEARLY:
PRATT & WHITNEY AIRCRAFT EXECUTIVE MANAGEMENT HOLIDAY SEASON PARTY

AMOUNT	$ 20 00
TAX	$ 60
TOTAL	$ 20 60

Ms. Gail Heiss

EXPLANATION Rental of Equipment

12-15-81	Venetian	spotlight	15.00
"	"	operator (½ hrs.)	5.00

20.00

2851 M/30
Rev. 6/77

PREPARED BY L Hawkins
SIGNATURE

Typed 12-21-81

12/09	501-008	PFF PRATT & WHITNEY	* 21012		750.00
12/17	321-013	TELEPHONE/LOCAL		.50	
12/17	311-001	BANQ/FLAC FOOD 12/15		104.00	
12/17	311-002	BANQ/FLAC FOOD 12/15		12109.50	
12/17	346-001	FLOWER SHOP		93.60	
12/21	325-012	BANQ/FLAC BEV 12/15		4268.89	
12/21	325-013	BANQ/FLAC WINE 12/15		1148.16	
12/21	364-015	A/V EQUIPMENT RENTAL		20.60	

OK [illegible]

Approved: Len Black 1/18/82

Dept. 170, Acct. 7498
Len Black, Vice President
Personnel & Industrial Relations

GPD A/P
JAN 22 1982
EXT.

CHARGES INCURRED ON YOUR DAY OF DEPARTURE MAY NOT BE REFLECTED ON THIS STATEMENT. AN INVOICE WILL BE MAILED TO YOU FOR SUCH DAY OF DEPARTURE CHARGES.

AMOUNT DUE ▶ 16,995.25

ALL AMOUNTS CHARGED ARE DUE UPON PRESENTATION OF YOUR BILL. FAILURE TO PAY FOR 60 DAYS AFTER THE DUE DATE WILL RESULT IN THE IMPOSITION OF A FINANCE CHARGE. THE FINANCE CHARGE WILL BE APPLIED TO THE PORTION OF THE PREVIOUS BALANCE MORE THAN 60 DAYS OLD AND WILL BE COMPUTED AT THE RATE OF 1½% PER MONTH. THIS IS AN ANNUAL PERCENTAGE RATE OF 18%. ALL PAYMENTS AND CREDITS ARE DEDUCTED FROM THE PREVIOUS BALANCE PRIOR TO THE COMPUTATION OF THE FINANCE CHARGE.

The Breakers
Palm Beach, Florida 33480

99741
7498
100

BEST COPY AVAILABLE

BEST COPY AVAILABLE

BANQUET/FUNCTION BEVERAGE

12-80

11184

	3569.30
SUB-TOTAL	3559.30
SERVICE CHARGE	533.40
STATE TAX	164.27
TOTAL	[illegible]

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

THE BREAKERS RECEIPT — CHECK NO. 11184

WAITER'S RECEIPT

BANQUET / FUNCTION WINE

12-81

06270

1				
2				
64	3	Wine	15.00	960.00
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				

ST	SUB-TOTAL	960.00
SC 15%	SERVICE CHARGE	144.00
TX 4%	STATE TAX	44.16
T	TOTAL	1148.16

PLEASE PRINT NAME

Pratt & Whitney

GUEST SIGNATURE

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

DATE — THE BREAKERS RECEIPT — AMOUNT — CHECK NO. 06270

DATE — WAITER'S RECEIPT — AMOUNT — CHECK NO. 06270

CHARGE

ROOM OR A/C NO. 33798 ID PR ☒ GUEST ☐ CITY LEDGER DATE 12/15/81

PRINT NAME CLEARLY: M/A033798

PRATT WHITNEY MGR

AMOUNT	$	5(
TAX	$	
TOTAL	$	5(

TELEPHONE NO. 585-9267

TIME OF CALL 727P

E. G.
SIGNATURE OF OPERATOR

THE BREAKERS

BANQUET/FUNCTION FOOD

11-80

10780

SUB-TOTAL

SERVICE CHARGE

STATE TAX

TOTAL

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

THE BREAKERS RECEIPT

WAITER S

10780

BEST COPY AVAILABLE

FLOWER SHOP

ROOM OR A/C NO 3379R	ID PR	☐ GUEST ☐ CITY LEDGER	DEPT CODE 70-25
		DATE 12/16/81	№ 5301
PRINT NAME CLEARLY: PRATT + WHITNEY		AMOUNT	90 –
		TAX	3 6
		TOTAL	93 6

EXPLANATION 2 Pedestals $45 ea

Venetian Ball Room

7:00

PREPARED BY ______ SIGNATURE

The Breakers
Palm Beach, Florida

BANQUET/FUNCTION FOOD

FORM 11-80

CHECK NO 10980

[illegible] @ 150.00 per 100 pcs		3750.00
[illegible] 200.00 per 100 pcs		3400.00
[illegible] @ 5.95 [illegible]		2975.00
	SUB-TOTAL	10,125.00
15%	SERVICE CHARGE	1518.75
4%	STATE TAX	465.75
	TOTAL	12,109.50

PLEASE PRINT NAME

GUEST SIGNATURE

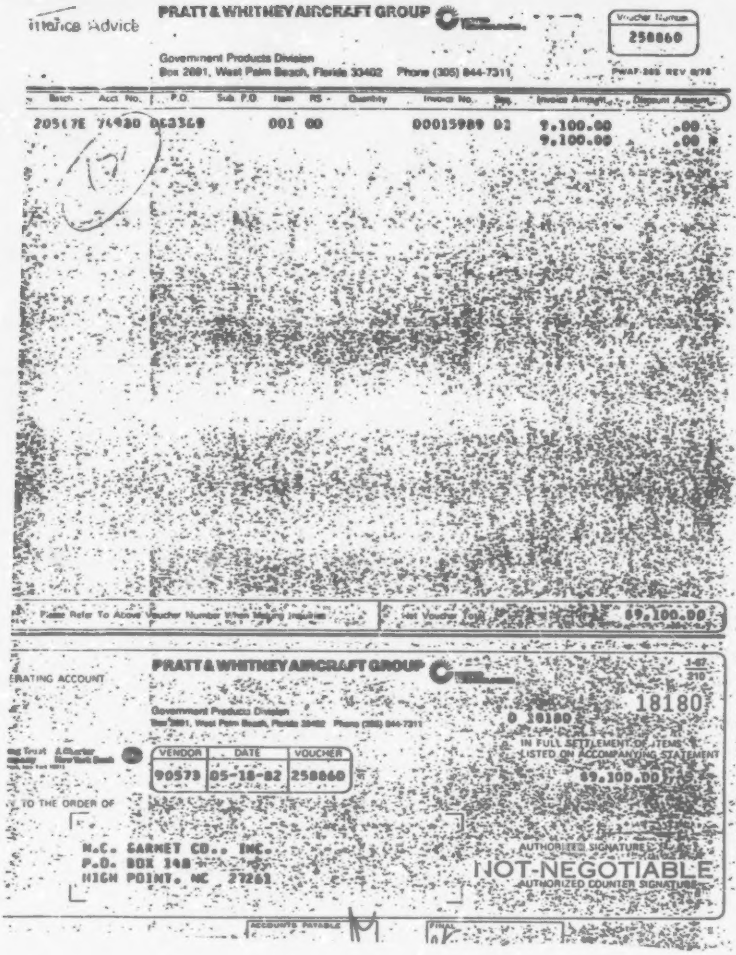
ACCT. NO 33796-PR

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

DATE | THE BREAKERS RECEIPT | AMOUNT | CHECK NO 10980

DATE | WAITER'S | AMOUNT | CHECK NO

BEST COPY AVAILABLE



Invoice Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

Voucher Number
258860

PWAF 385 REV 8/78

Batch	Acct No.	P.O.	Sub P.O.	Item	RS	Quantity	Invoice No.	Seq.	Invoice Amount	Discount Amount
20517E	74920	063369		001	00		00015989	02	9.100.00	.00
									9.100.00	.00

157

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $9.100.00

ERATING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

1-67
210

18180

0 18180

VENDOR	DATE	VOUCHER
90573	05-18-82	258860

IN FULL SETTLEMENT OF ITEMS
LISTED ON ACCOMPANYING STATEMENT

$9.100.00

TO THE ORDER OF

N.C. GARNET CO., INC.
P.O. BOX 148
HIGH POINT, NC 27261

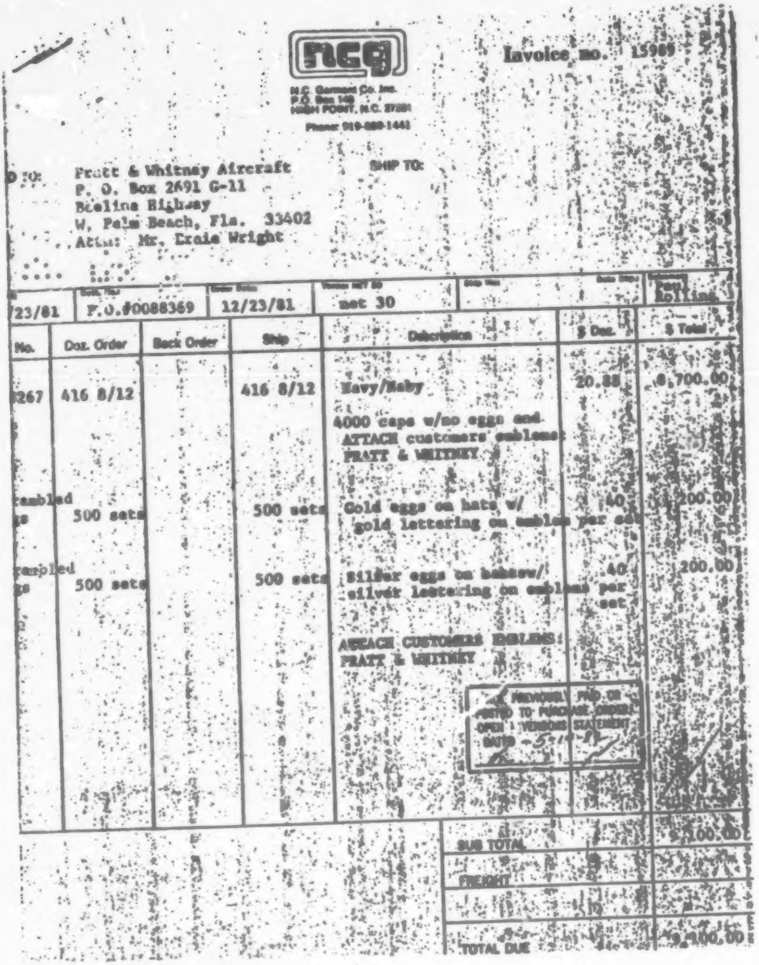
AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

ACCOUNTS PAYABLE

FINAL



NCG
N.C. Garment Co. Inc.
P.O. Box 149
HIGH POINT, N.C. 27261
Phone: 919-889-1441

Invoice no. 15989

TO:
Pratt & Whitney Aircraft
P. O. Box 2691 G-11
Beeline Highway
W. Palm Beach, Fla. 33402
Attn: Mr. Craig Wright

SHIP TO:

23/81	P.O.#0088369	12/23/81	net 30	Rolling

No.	Doz. Order	Back Order	Ship	Description	$ Doz.	$ Total
267	416 8/12		416 8/12	Navy/Navy 4000 caps w/no eggs and ATTACH customers emblems: PRATT & WHITNEY	20.88	8,700.00
ambled s	500 sets		500 sets	Gold eggs on hats w/ gold lettering on emblem per set	.40	200.00
ampled s	500 sets		500 sets	Silver eggs on hats w/ silver lettering on emblems per set ATTACH CUSTOMERS EMBLEMS: PRATT & WHITNEY	.40	200.00

PREVIOUSLY PAID OR
POSTED TO PURCHASE ORDER
OPEN VENDORS STATEMENT
DATED 5-1[illegible]

SUB TOTAL	9,100.00
FREIGHT	
TOTAL DUE	9,100.00

Purchase Order

PRATT & WHITNEY AIRCRAFT GROUP

F 88369

THERE IS NO SUBSTITUTE FOR QUALITY

Government Products Division
Box 2691 West Palm Beach, Florida 33402

Buyer J. P. McQuaid/jrs

Page 1 of 1

P.O. No 30467	Vendor No. & Code S-90573-A3-E	Contract No.	W.O. or Appropriation or CCN No.	Account No. 7490
Priorities & Limit Change		Prime Specifications		Florida Sales Tax Applies Yes ☐ No ☐
Special Specifications		Other Specifications		Date 1/7/82

Reproposition Applies Yes ☐ No ☐

2/26/82

S P C Applies		
1	7	13
2	8	14
3	9	15
4	10	16
5	11	17
6	12	18

N.C. Garmet Co, Inc.
P.O. Box 148
High Point, NC 27261

Item	Quantity	Part No.	Description	Price
	4,000		Baseball Caps	[redacted]
	500		Baseball Caps with gold scrambled eggs patches	
	500		Baseball Caps with silver scrambled eggs patches	

P.O. entered by phone 12/23/81 with Paul Rollins. Do not duplicate.

Do Not Overship

Total Commitment Value

9

C

Requirements Appr.	6	Engine Type	Inspection Required	F.O.B. SP	Net 30
Ship Via UPS	Deliver To Ernest B. Wright/G11 SR710 United, FL 33402 (F)	Material	Analysis Code		Department 802/802

Disposition	Inspected By	Date	Quantity Accepted	Quantity on R.R.D.	Part No./Chg. Ltr/Group No.

FINISHED OR ROUGH STORES INFORMATION

Rev.	Pre-Heat	Str. Col.	Location	Item	R.S.	Stored Qty	By	Date	Unit Wt.	Wt.

Date	Item	R.S.	Qty Rec'd.	Bal. Due	Carrier	Frt	W/B Number	Weight	P/S Number	Lot Number	
1/82	1	1	4,000	0	Pilot	C	0132-15016	110	OK	17-18219	[illegible]
	2		500	0						Direct to E. Wright	
	3		500	0							

TREASURY

F 88369

BEST COPY AVAILABLE

919 555-1212

ncg
N.C. Garment Co. Inc.
P.O. Box 148
HIGH POINT, N.C. 27261

CUSTOMER RELATIONS
MAY 11 1982
J. S. J.
R. A. M. F. B. W.

May 7, 1982

Pratt & Whitney Aircraft
P. O. Box 2691 C-11
West Palm Beach, FL 33402
Attn: Mr. Ernie Wright

P.O.
F 88369

Dear Mr. Wright,

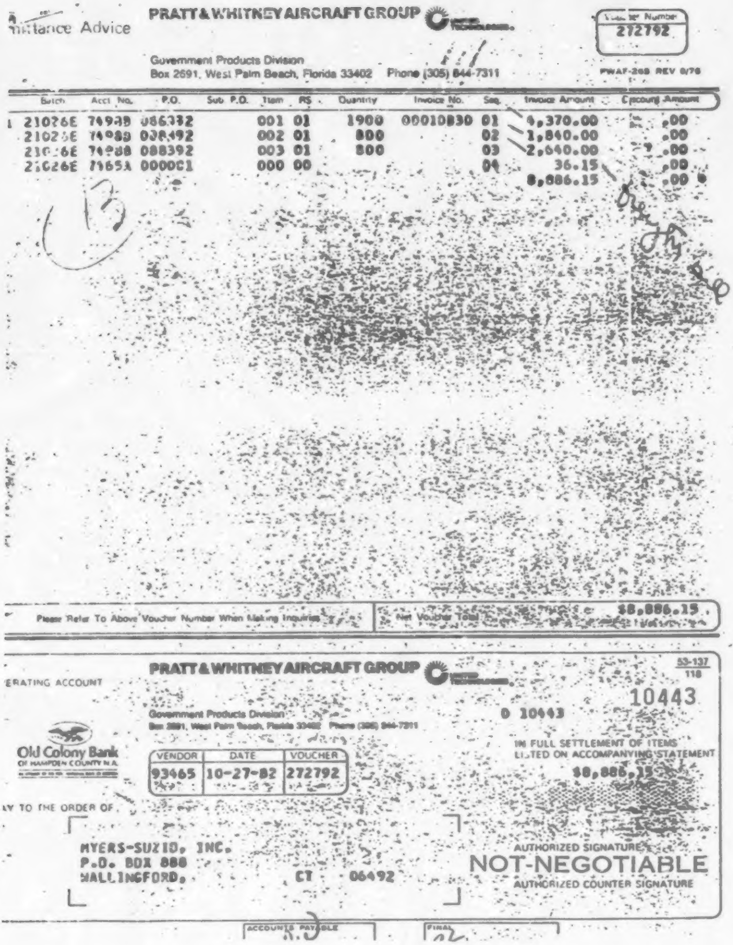
RE: PAST DUE INVOICE #15989

The above invoice was due for payment on 1/23/82. We would appreciate receiving your check by return mail. If this is not possible, a call from you letting is know when payment can be expected would help.

Cordially yours,

Maria Shoaf
Maria Shoaf, Acct. Mgr.

889-1441
Ballcaps.
Paul Rollins



mittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

Voucher Number
272792

PWAF-268 REV 6/76

Batch	Acct No.	P.O.	Sub P.O.	Item	RS	Quantity	Invoice No.	Seq.	Invoice Amount	Discount Amount
21026E	74939	086332		001	01	1900	00010830	01	4,370.00	.00
21026E	74989	038492		002	01	800		02	1,840.00	.00
21026E	74988	088392		003	01	800		03	2,640.00	.00
21026E	7465A	000001		000	00			04	36.15	.00
									8,886.15	.00

(13)

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $8,886.15

PRATT & WHITNEY AIRCRAFT GROUP

ERATING ACCOUNT

53-137
118

10443

D 10443

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

Old Colony Bank
OF HAMPDEN COUNTY N.A.

VENDOR	DATE	VOUCHER
93465	10-27-82	272792

IN FULL SETTLEMENT OF ITEMS
LISTED ON ACCOMPANYING STATEMENT

$8,886.15

AY TO THE ORDER OF

MYERS-SUZIO, INC.
P.O. BOX 888
WALLINGFORD, CT 06492

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

ACCOUNTS PAYABLE

FINAL

SUZIO
GIFT WORLD OF METAL

ERS-SUZIO INC 240 HALL AVENUE, P O BOX 888
LLINGFORD, CONN U S A 06492 (203) 269-4424

RECEIVED
OCT 1 1982
PWA

Shipping/Invoice Nº 010830
Date Shipped 9/30/82
Invoice Date 9/30/82
Purchase Order No F 88392

SOLD TO
Pratt & Whitney Aircraft Group -
Government Products Division
Florida Research & Development Center
P.O Box 2691
West Palm Beach, FL 33402
Attn: J. P. McQuaid

SHIP TO
Pratt & Whitney Aircraft Group
(F) SR 710 RA-G11
United, FL 33402
Attn: Ernie Wright

TERMS net 30 | SALES CODE | WEIGHT | VIA Carolina Freight

QUANTITY ORDERED	QUANTITY SHIPPED	B/O	DESCRIPTION	FINISH	PKG	UNIT PRICE	TOTAL PRICE
1900	1900	0	F100 engine tie tacs (complete)	4	1,3	$2.30 ea.	$ 4370.00
800	800	0	TF30 engine tie tacs (complete)	4	1,3	2.30 ea.	1840.00
~~[illegible]~~ 800	~~[illegible]~~ 800	0	J52 engine tie tacs (complete) (115 pieces shipped 9/13/82) (shipping memo #3517) 685 9-30-82	4	1,3	2.55 ea.	2040.00

$ 36.15 freight bill attached for 9-13-82 shipment
freight for Carolina to follow

As per our agreement we are billing a partial
Please send it along for payment.
Thanks.

Embedment part will be billed later.

SUB-TOTAL	$ 8250.00
SALES TAX	
PREPRODUCTION	600.00
DELIVERY	36.15
TOTAL	$8886.15

FINISH Gold Plate - 1, Rhodium Plate - 2, White - 3, Pewter - 4, Other - 5
PACKAGING Poly Bag - 1, Card - 2, Box - 3, Bulk - 4, Other - 5
White - Original / Green - Duplicate / Canary - Office File / Pink - Sales Copy / Goldenrod - Packing Slip

BEST COPY AVAILABLE

.cR 10/11
no 5078
r 10/09/82

UNITED TECHNOLOGIES PRATT & WHITNEY AIRCRAFT

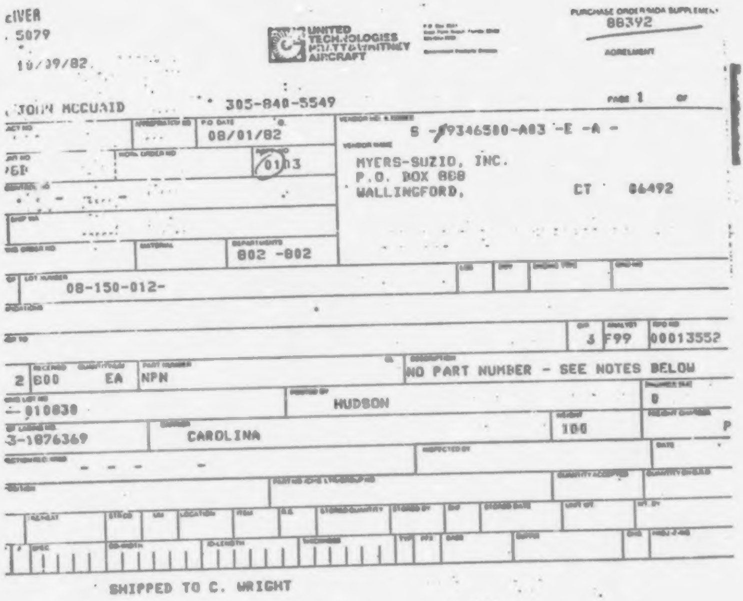
PURCHASE ORDER/AMDA BUY
88392
AGREEMENT

BR JOHN MCQUAID 305-840-5549
PAGE 1 OF

P.O. DATE	08/01/82	VENDOR NO & CODES	S -19346508-A03 -E -A -
	YP3		0102
VENDOR NAME	MYERS-SUZIO, INC. P.O. BOX 088 WALLINGFORD, CT 06492		
DEPARTMENTS	802 -802		
LOT NUMBER	08-150-012-		
	3	F99.	0001355
RECEIVED QUANTITY	1 1908 EA	PART NUMBER	NPN
DESCRIPTION	NO PART NUMBER - SEE NOTES BELOW		
	- 010830	POSTED BY	HUDSON
	8		
BILL OF LADING NO	63-1876369	CARRIER	CAROLINA
WEIGHT	180		

SHIPPED TO C. WRIGHT

BEST COPY AVAILABLE



ᴇIVER
. 5079
10/39/82.

UNITED TECHNOLOGIES PRATT & WHITNEY AIRCRAFT

PURCHASE ORDER/NOA SUPPLEMENT
88392
AGREEMENT

JOHN MCCUAID 305-840-5549

PAGE 1 OF

P.O. DATE 08/01/82

S -79346580-A03 -E -A -

VENDOR NAME
MYERS-SUZIO, INC.
P.O. BOX 888
WALLINGFORD, CT 06492

ᴦGE
01 03

DEPARTMENTS 802 -802

LOT NUMBER 08-150-012-

3 F99 00013552

2 800 EA NPN

DESCRIPTION NO PART NUMBER - SEE NOTES BELOW

-- 010830

HUDSON

0

3-1076369

CAROLINA

100

P

SHIPPED TO C. WRIGHT

9

BEST COPY AVAILABLE

. . IS NO SUBSTITUTE FOR QUALITY

F 88392

Government Products Division
Box 2691 West Palm Beach, Florida 33402

Buyer J.P. MCQUAID/ch

Page 1 of 1

PWA GPD 3393 REVISED

P.O. No 3552
Vendor No. & Coding S-92465-A3-E-A
Contract No
W.O. or Appropriation or CCN No. (S)
Account No. (S) 7498B
P Number & Latest Change
PWA* Specifications
Florida Sales Tax App Yes ☐ No ☐
Material Specifications
Other Specifications
Date 8-24-82
To Be In Accordance
Renegotiation Applies Yes ☐ No ☐
11-11-82

S P C Applies		
1	7	13
2	8	14
3	9	15
4	10	16
5	11	17
6	12	18

MYERS-SUZIO, INC.
P.O. BOX 888
WALLINGFORD, CT 06492
ATTN: LEONARD F. SUZIO

Item	Quantity	Description	Price
	1,900 EA	F100 ENGINE (PEWTER) TIE TA	[redacted]
	800 EA	TF30 ENGINE (PEWTER) TIE TA	[redacted]
	800 EA	J52 ENGINE (PEWTER) TIE TA	[redacted]
		PLUS SET-UP CHARGE:	[redacted]
	100 EA	J52 PRISMS 2 1/8" LONG ENG	[redacted]
		PLUS SET-UP CHARGE:	[redacted]

TELEPHONE ORDER PLACED 8-18-82 WITH L. SUZIO. DO NOT DUPLICATE.

9

DO NOT OVERSHIP

TOTAL COMMITMENT VALUE: [redacted]

P

Requirements
O/S 3
Engine Type
Inspection Required
F.O.B. SP
N/30
Ship Via
CARRIERS
UP TO 50# UPS; OVER CAROLINA FRT, UNITED FL (F)
Deliver To ERNIE WRIGHT SR710 BA-G11
Material
Analyst Code
Departments 802

DISPOSITION	INSPECTED BY	DATE	QUANTITY ACCEPTED	QUANTITY IN Q.R.O.	PART NO./CHG. LTR/GROUP NO

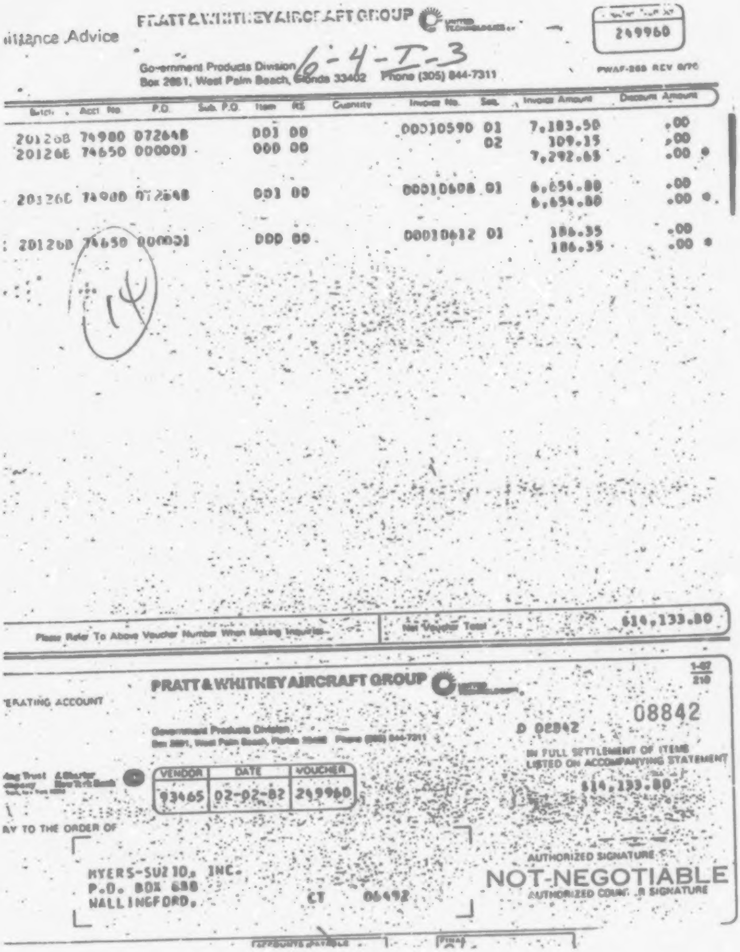
FINISHED OR ROUGH STORES INFORMATION

	FAB/HEAT	STK. CD	UM	LOCATION	ITEM	R.S.	STORED QTY	BY	DATE	UNIT WT.	WT. BY

DATE	ITEM	R.S.	QTY REC'D	BAL. DUE	CARRIER	FRT	W/B NUMBER	WEIGHT	P/S NUMBER	LOT NUMBER	REC'D BY
E	3	1C	115	685	Fed X	P	14443763	5	3517	14-133-1-82	
								C			

F 88392

TREASURY



ittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

6-4-I-3

249960

PWAF-269 REV 8/76

Batch	Acct No	P.O.	Sub. P.O.	Item	RS	Quantity	Invoice No.	Seq.	Invoice Amount	Discount Amount
201268	74980	072648		001	00		00010590	01	7,183.50	.00
201268	74650	000001		000	00			02	109.15	.00
									7,292.65	.00 *
201268	74980	072648		001	00		00010608	01	6,654.80	.00
									6,654.80	.00 *
201268	74650	000001		000	00		00010612	01	186.35	.00
									186.35	.00 *

14

Please Refer To Above Voucher Number When Making Inquiries.

Net Voucher Total $14,133.80

PRATT & WHITNEY AIRCRAFT GROUP

1-87
210

ERATING ACCOUNT

08842

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

D 08842

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
93465	02-02-82	249960

$14,133.80

AY TO THE ORDER OF

MYERS-SUZIO, INC.
P.O. BOX 688
WALLINGFORD, CT 06492

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

ACCOUNTS PAYABLE

WORLD OF METAL

ZIO INC., 240 HALL AVENUE P.O. BOX [illegible]
ORO CONN U.S.A. [illegible] [illegible]

Shipping/Invoice № 010590

Date Shipped 12/14/81

Invoice Date 12/21/81

Purchase Order No. F 72648

Pratt & Whitney Aircraft Group
Florida Research & Development
P.O. Box 2691
West Palm Beach, FL 33402

Pratt & Whitney Aircraft Group
(F)
SR. 710
United, FL 33402

Attn: John McQuaid

QUANTITY PARTIAL			TERMS NET 30	SALES CODE	WEIGHT	VIA [illegible] Carolina Freight		
D	SHIPPED	B/O	DESCRIPTION		FINISH	PKG	UNIT PRICE	TOTAL PRICE
0	225	50	F-100 with F-16 embedment #3		pwtr	3	$15.95 ea.	$3588.75
0	140	21	F-100 with F-15 embedment #2		"	"	15.95 ea.	2233.00
0	25	0	TF-30 with F-111 embedment [illegible]		"	"	15.95 ea.	398.75
0	30	224	TF-30 with F-14 embedment [illegible]		"	"	15.95 ea.	478.50
0	34	62	F-100 engine embedment #1		"	"	14.25 ea.	484.50
					SUB-TOTAL			$7183.50
					SALES TAX			
					PRE-PRODUCTION			
					DELIVERY			109.15
					TOTAL			$7292.65

Partial invoice on this job. Please expedite for payment. Balance to follow before Jan. 1, 1982. Copy of freight bill for second shipment enclosed. Freight on this shipment will be forwarded when received for Carolina.

RECEIVED
DEC - 6 1982
TREASURY DEPT.

Ref: Rec. #3 (12-1-81) on FRT. CHg.

A/c #74650
P.O. #1

Gold Plate - 1, Rhodium Plate - 2, White - 3, Powder - 4, Other - 5
PACKING Poly Bag - 1, Card - 2, Box - 3, Bulk - 4, Other - 5
Original / Green - Duplicate / Canary - Office File / Pink - Sales Copy / Goldenrod - Packing Slip

BEST COPY AVAILABLE

TO OPEN TEAR ... USE THUMB NOTCH TO REMOVE CONTENTS

CAROLINA FREIGHT CARRIERS CORP. (CFCC)
PHONE (704) 435 6811

ORIGINAL FREIGHT BILL

FREIGHT BILL NO. 063-1587479

WPD DEST. TERM NFD ORIG. TERM	Consignee: PRATT & WHITNEY AIRCRAFT GRP F SH 710 UNITED FL 33402	Shipper: MYERS SUZIO INC 240 HALL AVE WALLINGFORD CT 06492				
PIECES	DESCRIPTION OF ARTICLES		TYPE CHARGE/CONDITION	WEIGHT	RATE	CHARGES
14	PEWTER CAST ENGINE - PLEN EMBODED IN PLST		PREPAID	546	1948	105.97
		3.0 %	FUEL SUR			3.18
14	TTL			546		****109.15

BILL TO:
MYERS SUZIO INC
240 HALL AVE
WALLINGFORD CT
06492

ORIG. C/L	C/L PRO. #	TPP	DEST. C/L	TPZ

THIS IS YOUR COPY

SHIPMENT DATE 11/18/81

SHIPPER B/L NO. NA

DATE BILLED 11/23/81

PAY THIS AMOUNT $ ****109.15

REMIT TO CAROLINA FREIGHT CARRIERS ... CHERRYVILLE, N.C. 28021

ICC REQUIRES PAYMENT WITHIN 7 DAYS

RECEIVED
DEC -6 1982
TREASURY DEPT

INTER DEPARTMENT TRANSMITTAL

TRANSFERRED TO: Dick

___ DISCREPANCY SECTION: 4

A. PRICE INVOICED -vs- P.O. PRICE

B. QTY INVOICED -vs- REC'D QTY

C. NAME VARIANCE

D. PROOF OF DELIVERY

E. NEED NET WT. ON RECEIVER

OUT
1-22-82

[✓ F.] MISC. Pmt appr.

___ APPROVAL DESK

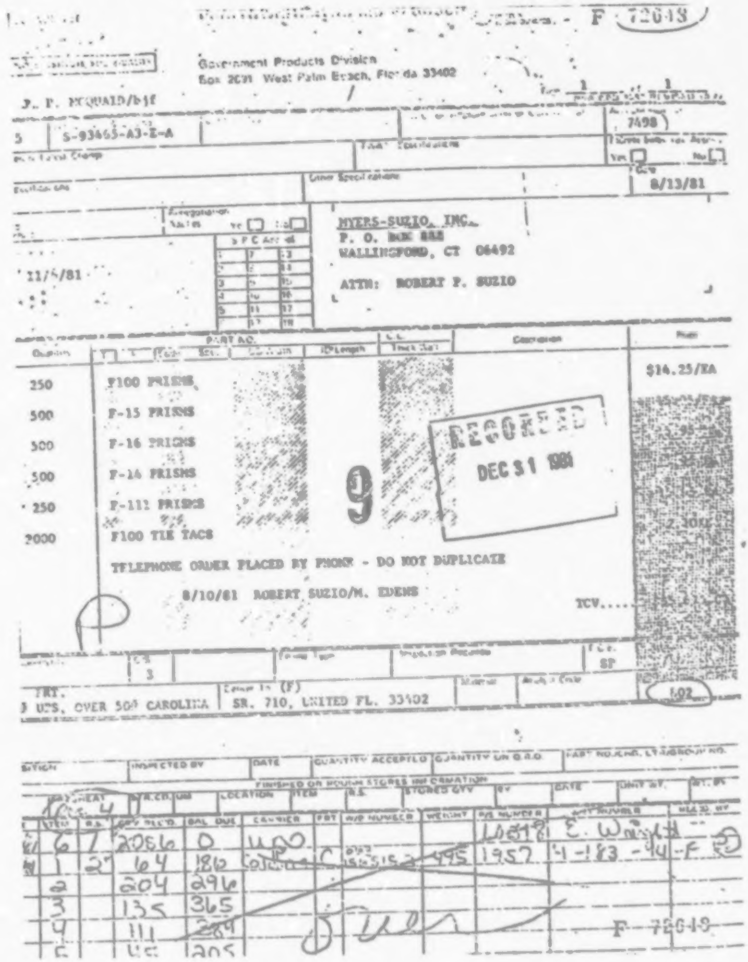
___ NON-P.O. DESK

___ COMPUTER RENTAL

INITIALS

DATE 1/11/82

215-8



F 72048

Government Products Division
Box 2691 West Palm Beach, Florida 33402

P. P. MCQUAID/bjf

5 | S-93463-A3-E-A

7498

Yes ☐ No ☐

8/13/81

Yes ☐ No ☐

11/5/81

MYERS-SUZIO, INC.
P. O. BOX 882
WALLINGFORD, CT 06492

ATTN: ROBERT P. SUZIO

Quantity	Part No.	Price
250	F100 PRISMS	$14.25/EA
500	F-15 PRISMS	
500	F-16 PRISMS	
500	F-14 PRISMS	
250	F-111 PRISMS	
2000	F100 TIE TACS	

TELEPHONE ORDER PLACED BY PHONE - DO NOT DUPLICATE

8/10/81 ROBERT SUZIO/M. EDENS

TCV....

RECORDED
DEC 31 1981

9

3

SP

FRT.
3 UPS, OVER 50# CAROLINA

Deliver To (F)
SR. 710, UNITED FL. 33402

602

Item	B.O.	Qty Recd	Bal Due	Carrier	Frt	W/B Number	Weight	P/S Number		
6	7	2086	0	UPS				16818	E. Wright	
1	27	64	186	Collins	C	15 15 15 2	495	1957	4-183-44	F
2		204	296							
3		135	365							
4		111	289							
5		115	205							

F 72048

RECEIVING REPORT CONTINUATION SHEET

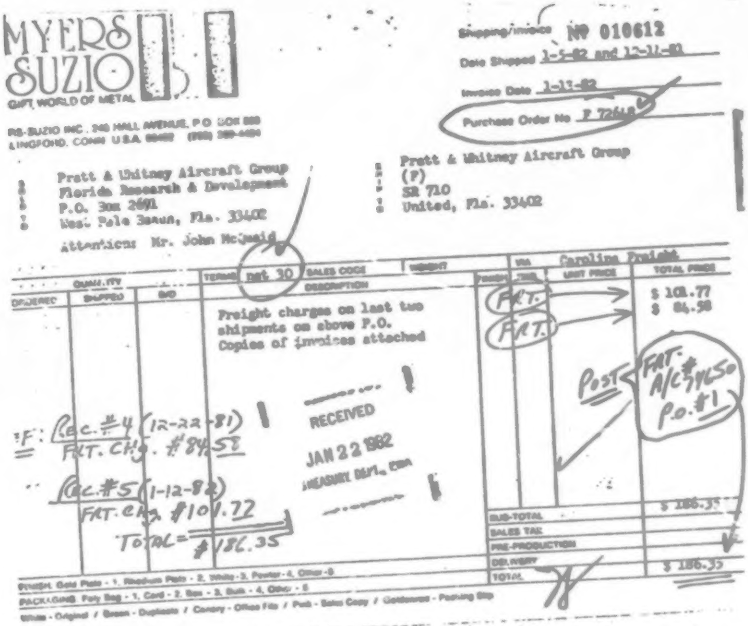
PURCHASE ORDER
7[illegible]4[illegible]

2 of ____ Pages

Myers Surgic

Item	R.S. No.	[illegible]	Quantity Received	Balance Due	Carrier	Frt. Chgs.	W/B Number	Wt.	P/S No.	Heat No.	Received B.
1	2		40	96	Carolina	C	1587579	500	1350		
2			125	161							
3			90	275							
4			125	254							
5			180	25			Tot 30 = 235 [illegible]				
1	3		34	62	Carolina	C	1161197		3590		[illegible]
2			140	21							
3			225	50							
4			30	224							
5			25	0	9		17-175	3 [illegible]	[illegible]		[illegible]

BEST COPY AVAILABLE



MYERS SUZIO
GIFT WORLD OF METAL

MYERS-SUZIO INC., 240 HALL AVENUE, P.O. BOX [illegible]
WALLINGFORD, CONN U.S.A. [illegible] ([illegible]) [illegible]

Shipping/invoice Nº 010612
Date Shipped 1-5-82 and 12-11-81
Invoice Date 1-13-82
Purchase Order No. P 72648

SOLD TO
Pratt & Whitney Aircraft Group
Florida Research & Development
P.O. Box 2691
West Palm Beach, Fla. 33402
Attention: Mr. John McQuaid

SHIP TO
Pratt & Whitney Aircraft Group
(F)
SR 710
United, Fla. 33402

Terms net 30 | Sales Code | Weight | Via Carolina Freight

Quantity Ordered	Quantity Shipped	B/O	Description	Finish	Type	Unit Price	Total Price
			Freight charges on last two shipments on above P.O. Copies of invoices attached		FRT.		$ 101.77
					FRT.		$ 84.58
				SUB-TOTAL			$ 186.35
				SALES TAX			
				PRE-PRODUCTION			
				DELIVERY			
				TOTAL			$ 186.35

Post FRT. A/C # 74650 P.O. #1

RF: Rec. #4 (12-22-81)
FRT. CHG. $84.58
Rec. #5 (1-12-82)
FRT. CHG. $101.77
TOTAL = $186.35

RECEIVED
JAN 22 1982
TREASURY DEPT., [illegible]

FINISH: Gold Plate - 1, Rhodium Plate - 2, White - 3, Pewter - 4, Other - 5
PACKAGING: Poly Bag - 1, Card - 2, Box - 3, Bulk - 4, Other - 5
White - Original / Green - Duplicate / Canary - Office File / Pink - Sales Copy / Goldenrod - Packing Slip

INTER DEPARTMENT TRANSMITTAL

TRANSFERRED TO:

#4 DISCREPANCY SECTION: Dick

A. PRICE INVOICED -vs- P.O. PRICE

B. QTY INVOICED -vs- REC'D QTY

C. NAME VARIANCE

D. PROOF OF DELIVERY

E. NEED NET.WT. ON RECEIVER

[✓ F.] MISC. TRAFFIC APPROVAL

___ APPROVAL DESK ___

___ NON-P.O. DESK ___

___ COMPUTER RENTAL ___

INITIALS

1-22-82

DATE

215-8

BEST COPY AVAILABLE

TO OPEN TEAR ALONG THIS PERFORATION ↓
↓ USE THUMB NOTCH TO REMOVE CONTENTS

063-1610197

	Shipper	Consignee
WPD	PRATT & WHITNEY AIRCRAFT GROUP (F) SR. 710 UNITED FL 33402	MYERS-SUZIO INC 240 WALL AVE WALLINGFORD CT. 06492
PPD		

13	PEWTER CAST MINI-PLANES & ENGINES	PREPAID	304	2452	74.54
	IN PLASTIC PRISON	SNGL SHP		FC	7.50
	3.1 %	FUEL SUR			2.54
13	TTL		304		*****84.58

BILL TO.

MYERS-SUZIO INC
240 WALL AVE
WALLINGFORD CT
06492

SHIPMENT DATE	12/14/81
SHIPPER B/L NO.	NA
DATE BILLED	12/17/81

PAY THIS AMOUNT
$ *****84.58

RECEIVED
JAN 22 1982

178

178

045-1623295

WPP MFD	PRATT & WHITNEY AIRCRAFT S R 710 UNITED FL 33402	MYERS SUZIO INC 240 HALL AVE WALLINGFORD CT 06492

13	PEWTER CAST ENGINES & PLANES IN ACRYLIC	PREPAID	372	2432 R	91.21
		SNGL SHP			7.50
	3.1 %	FUEL SUR			3.06
13	TTL		372		****101.77

BILL TO:
MYERS SUZIO INC
240 HALL AVE
WALLINGFORD CT
06492

[illegible] 01/05/82
[illegible] NA
[illegible] 01/07/82

PAY THIS AMOUNT $ ****101.77

RECEIVED
JAN 22 1982
[illegible]

179

BEST COPY AVAILABLE

179

SUZIO [illegible]

[illegible]

Shipping Order [illegible]
Date Shipped [illegible]
Invoice Date [illegible]
Purchase Order No. [illegible]

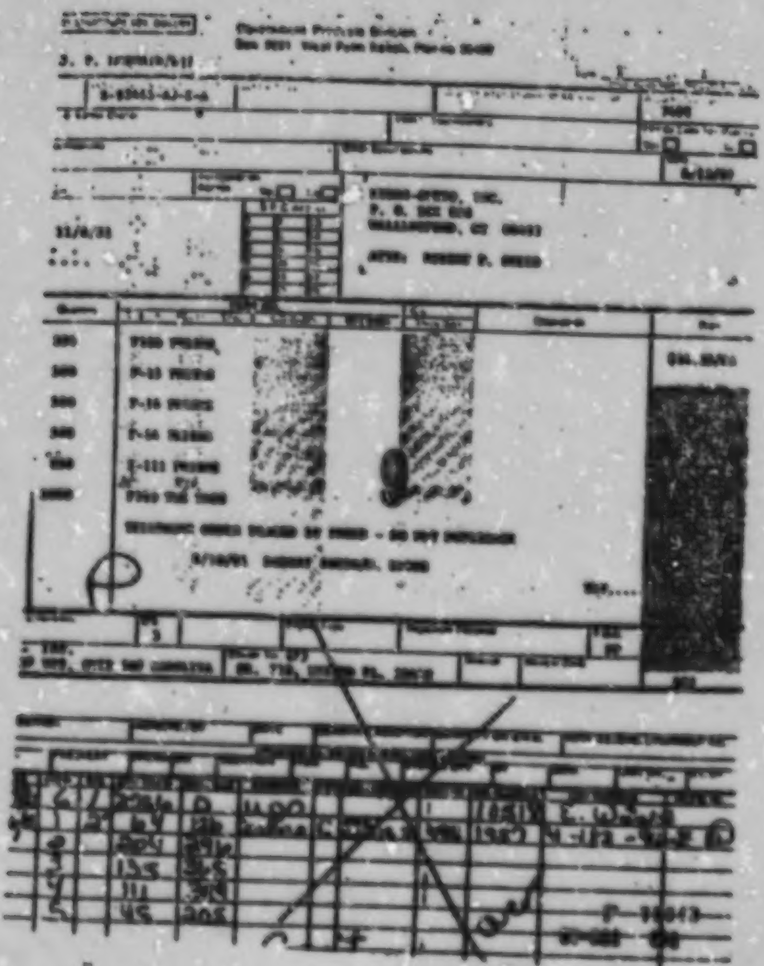
Pratt & Whitney Aircraft Group
Florida Research & Development
P.O. Box [illegible]
West Palm Beach, Fla. [illegible]
Attention: John [illegible]

Pratt & Whitney Aircraft
[illegible]
SR 710
[illegible], Fla. [illegible]

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	P-100 with P-14 attachment	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	P-100 with P-15 attachment	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible] with P-14 attachment	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	P-100 engine attachment	[illegible]	[illegible]	[illegible]	[illegible]
			This order is now complete. Freight charges to follow.				

RECEIVED
JAN [illegible]
[illegible]

BEST COPY AVAILABLE



WALLINGFORD, CT

ATTN:

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182

RECEIVING REPORT CONTINUATION SHEET

[illegible]
72648

2

[illegible]

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1	2		90	96	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		
2			135	161							
3			90	275							
4			135	254							
5			180	25			[illegible] 30-235		14[illegible]		
1	4		34	62	[illegible]	C	[illegible]		[illegible]		[illegible]
2			140	21							
3			335	50							
4			30	324							
5			25	0			17-175	13	[illegible]	[illegible]	[illegible]
1	5		26	26	[illegible]	C	[illegible]	[illegible]	[illegible]		[illegible]
2			61	0							
3			91	0							
4			342	0			12-6	23-F			

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Remittance Advice

PRATT & WHITNEY AIRCRAFT GROUP

15

PRATT & WHITNEY AIRCRAFT GROUP

NOT NEGOTIABLE

BEST COPY AVAILABLE

184

PGA Sheraton Resort

[illegible]

01

[illegible]/[illegible] -PMAIR2
ATTN: MR GAIL W [illegible]
PO BOX [illegible]
W PALM BEACH, FL [illegible]402

P.O. 102566
c/c 91104

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
JUN19	171	048[illegible]	BANQUET FD	18,975.00	03 3
JUN19	171	048[illegible]	BANQUET BV	10,423.00	03 3
JUN19	171	048[illegible]	BEV LABOR	320.00	03 3
JUN19	171	[illegible]	ELECTRICAL	120.00	03 3
JUN19	171	[illegible]	SVC CHARGE	4,417.20	03 3
JUN19	171	[illegible]	TAX-RES BQ	1,[illegible]	03 3
JUN19	171	[illegible]	BANQUET FD	7,[illegible]	03 2
JUN19	171	[illegible]	SVC CHARGE	1,062.00	03 2
JUN19	171	[illegible]	TAX-RES BQ	407.38	03 2
JUN24	42[illegible]	[illegible]	MISC	440.00CR	42
			TOTAL-DUE	43,678.91	

APPROVED

P.O. [illegible]

RECORDED
JUN 30 [illegible]

OK to Pay

06/16/82
06/17/82
00
PMAIR2
00

[illegible]

PGA Sheraton Resort

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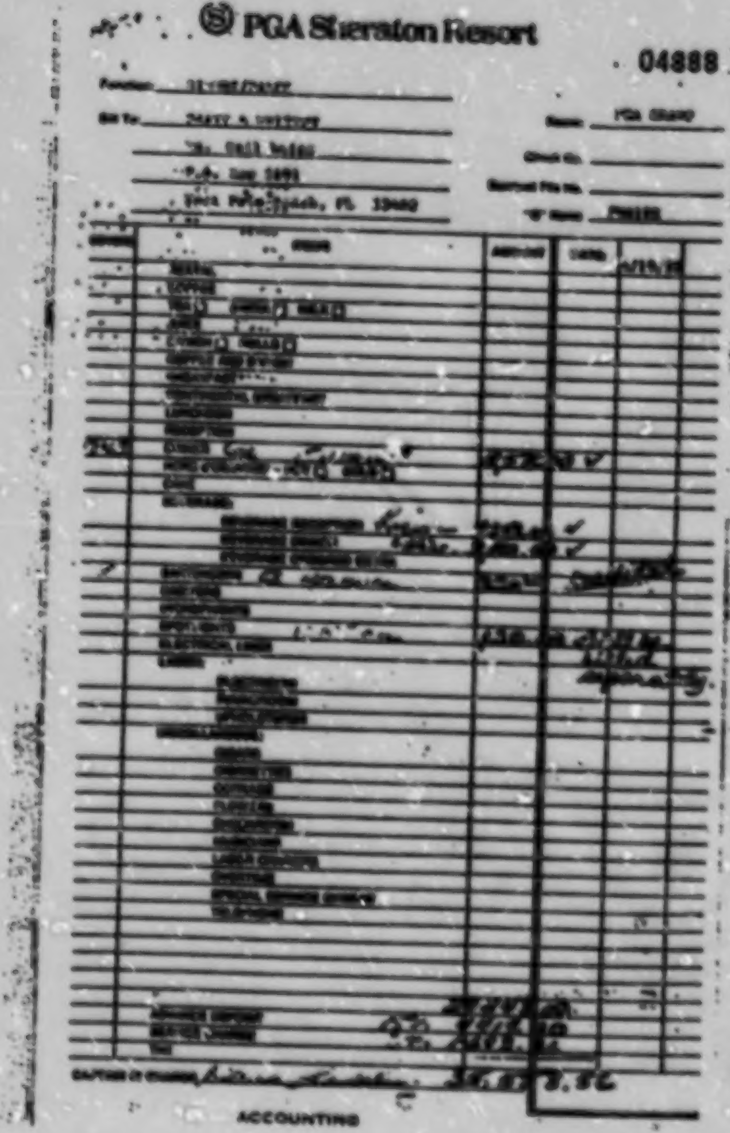


PGA Sheraton Resort

04888

[illegible]

ACCOUNTING

PGA Sheraton Resort

04887

[illegible] [illegible]

[illegible] [illegible]

[illegible]

[illegible] Box 2091

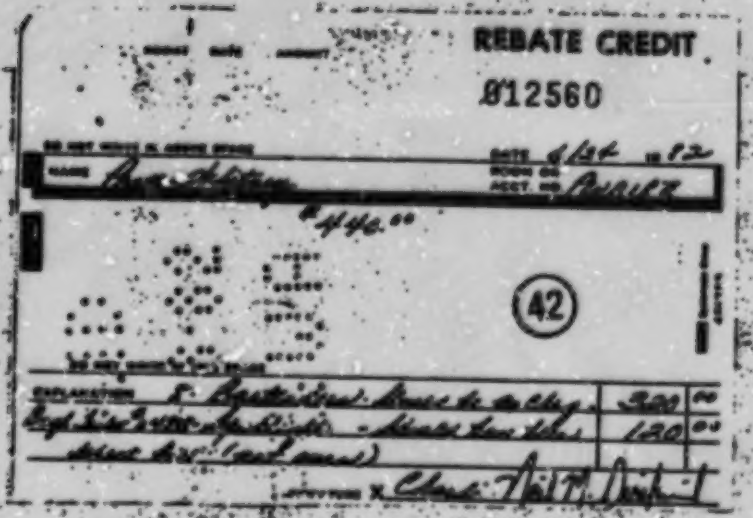
West Palm Beach, FL 33402

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]/19/82
	[illegible]	[illegible]		

[illegible] 8554.35

ACCOUNTING

BEST COPY AVAILABLE



REBATE CREDIT

012560

DATE 6/24 19 72

ROOM NO.

NAME [illegible]

ACCT. NO. [illegible]

$446.00

㊷

EXPLANATION [illegible]	300	00
[illegible]	120	00
[illegible]		

APPROVED X [illegible]

Remittance Advice [illegible]

Government Products Division
[illegible]

[illegible]

[illegible]

[illegible] 41100 [illegible]

16

[illegible] [illegible]

PRATT & WHITNEY AIRCRAFT GROUP

[illegible]

JUN 12 1981 94105

Government Products Division
[illegible]

[illegible]

[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]

[illegible]

[illegible]

[illegible]

NOT-NEGOTIABL

[illegible]

CHECK REQUEST FORM

TO:	Charlie Feeley 883	/	w/c 93951
FROM:	Tom Bean	EXT.	2409
DATE:	6/2/81		

Would you please request a check as follows:

approved amount to follow. Flowers being delivered 6/4/81

AMOUNT: $813.70

ISSUED TO: Thomas House, Ltd.

FOR: 390 corsages including tax and delivery for Fighter Fling Ball NAS Oceana

CHARGE TO: DEPT. NO. 881 / ACCT. NO. 2400

Please return this check to Customer Relations ~~2A83~~ for transmittal.

902-5

APPROVED

To: Tom Bean
M/S A87

Date: 6-15

The attached invoice for rose corsages for the Fighter Fling is forwarded for record purposes. The Pratt & Whitney check for payment in full was delivered to Mrs. Thomas on 6-12-81.

Ray F. Fitzpatrick

Charlie - This should be at your file on the check.

Tom Ba

PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

THOMAS HOUSE LTD.

Singles	780	00
Corsages 26 @ 1.20	31	20
	811	20
Del.	2	50
	813	70
Thank You		

BEST COPY AVAILABLE

[illegible] Advice

92995

Government [illegible]
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844 7311

[illegible]	Date	Acct No.	P.O.	[illegible]	Quantity	Invoice No.	Seq	Invoice Amount	Discount Amount
ATLANTA ATHLETIC CLUB						18201		$538.10	

[illegible]	Net Voucher Total $538.10

OPERATING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2011

MAR 2 0 1981

92995

VENDOR	DATE	VOUCHER
98934	3-16-81	92995

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEM

$538.10

PAY TO THE ORDER OF

ATLANTA ATHLETIC CLUB

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶ Pdr

CHECK REQUEST FORM

TO: Charlie Feeley A83 /

FROM: Jim Holloway EXT.

DATE: 3/16/81

****

Would you please request a check as follows:

AMOUNT: $336.10

ISSUED TO: Atlanta Athletic Club

FOR:	PGA Championship tickets	2 @ $79.00	$158.00
		2 @ $200.00	400.00

CHARGE TO: DEPT. NO. 816 / ACCT. NO. 7498

Please return this check to Customer Relations (A83) for transmittal.

J. T. Holloway

802-5

APPROVED

REMITTANCE ADVICE

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) [illegible]

[illegible]

PRATT & WHITNEY AIRCRAFT GROUP

DEC 15 19[illegible]

96352

[illegible]

NOT-NEGOTIABL

CHECK REQUEST FORM

TO: Charlie Feeley /

FROM: Jan Jasminski EXT. 2429

DATE: 12/8/81

Would you please request a check as follows:

AMOUNT: $7,000.00

ISSUED TO: Burt Reynolds Dinner Theater

FOR: (8) units, 1982 Winter/Spring season

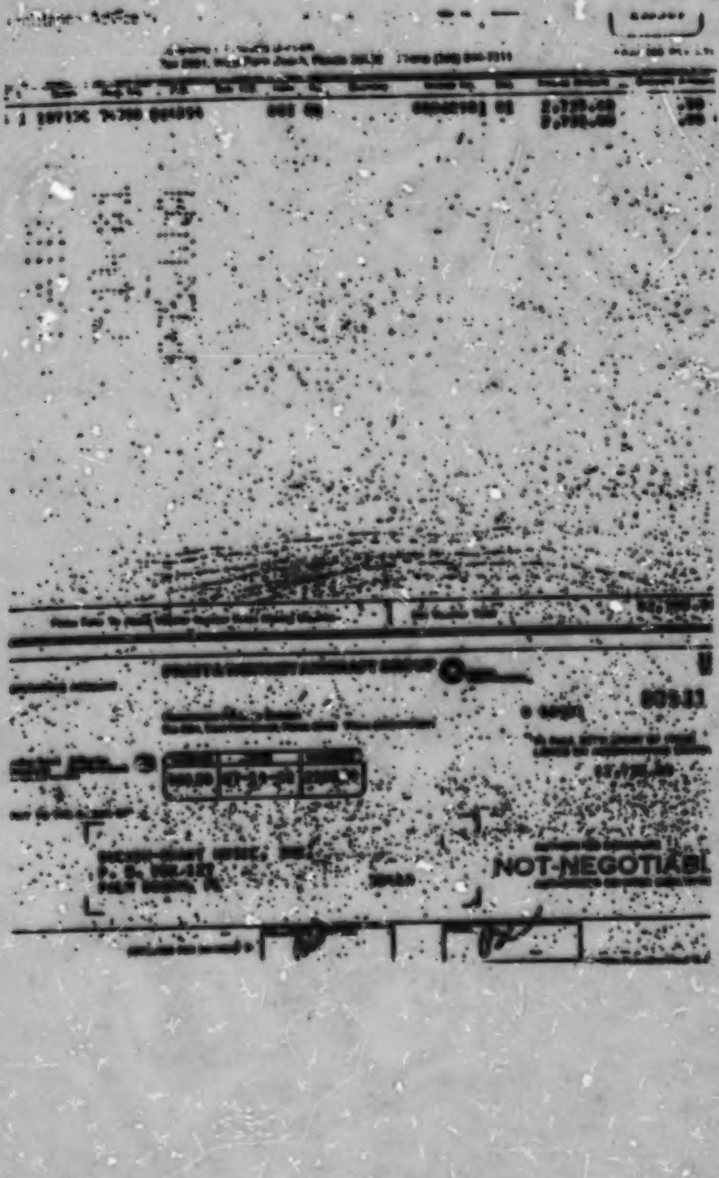
CHARGE TO: DEPT. NO. 882 / ACCT. NO. 7498

Please return this check to Customer Relations (883) for transmittal.

903-3

APPROVED

BEST COPY AVAILABLE



NOT-NEGOTIABL

Lucien-Grant Music, Inc.
Post Office Box [illegible]
Palm Beach, Florida 33480
[illegible]

GPD F.P.
JUL 8 1981
EXT.

Mrs. Gail Weiss
Pratt & Whitney Aircraft Group
Government Products Division
P. O. Box 2691
Mail Stop A-15
West Palm Beach, Florida 33402

June 29th, 1981

Saturday, June 27th, 1981

Eight Strolling Musicians 6:15 - 9:15P.M.	$1,300.00
Seven Musicians 8:15 - 11:15P.M.	1,150.00
Half hour additional playing @	285.00
Total Balance Due	$2,735.00

Approved ______________________
Lee Black, Vice President
Personnel and Industrial Relations
Dept. 100 - Acct. 3038
P. O. No. [illegible]

BEST COPY AVAILABLE

243308

[illegible]

2 111076 [illegible] [illegible] 1,990.34 .00
1,990.34 .00

[illegible]

01679

[illegible]

[illegible]	11-13-81	243308

[illegible]

NOT-NEGOTIABL

BEST COPY AVAILABLE

SEMINAR FOR EXECUTIVES' SPOUSES

20 October 1981

Old Port Cove Yacht Club

Attendees

A Fran Alley (Mrs. W.R. "Bill")
Joan Atherton (Mrs. R.R. "Bob")
A Bonnie Bellak (Mrs. S. "Si")
A Roberta Bloch (Mrs. L.E. "Len")
A Delores Browning (Mrs. G.F. "Jerry")
Darlene Bryan (Mrs. E.C. "Ernie")
A Mimi Churchill (Mrs. L.O. "Les")
Barbara Clarkson (Mrs. L.W. "Larry")
A Lou Coar (Mrs. R.J. "Dick")
Mary Cronlein (Mrs. W.E. "Bill")
A Mary Corvino (Mrs. S.J. "Sal")
Jean DeSantis (Mrs. L.L. "Lou")
A Terry Dwyer (Mrs. W.T. "Bill")
A Barbara Ford (Mrs. R.E. "Ed")
Mary Guthrie (Mrs. R.J. "Jack")
A Edie Hampton (Mrs. T.L. "Tom")
Pat Harvey (Mrs. S.S. "Steve")
A Pamela Houston (Mrs. S.O. "Sam")
Agnes Howell (Mrs. W.L. "Bill")
A Nancy Hussey (Mrs. K.J. "Kent")
Pat Jones (Mrs. R.J. "Bob")
Joan King (Mrs. W.A. "Bill")

Sonia Koff (Mrs. D.L. "Don")
A Grace Ledwith (Mrs. W.A. "Walt")
Peg McAbee (Mrs. F.W. "Frank")
A Kathleen McDermott (Mrs. J.P. "Jack")
Jane McConnell (Mrs. B.J. "Bernie")
A Carol Miesimer (Mrs. W.C. "Bill")
Janet Moore (Mrs. J.B. "Joe")
A Dodie Nemm (Mrs. J.S. "Sid")
Maxine Peck (Mrs. C.A. "Charlie")
A Jane Pinsley (Mrs. E.A. "Ed")
A Marcia Potter (Mrs. E.A. "Ed")
Beverly Schofield (Mrs. J.M. "Jack")
Carol Stetson (Mrs. H.D. "Hal")
A Carolyn Snavely (Mrs. C.E. "Craig")
Farrell Webb (Mrs. W.L. "Bill")
Alexandra Witt (Mrs. D.L. "Don")
A Alice Zipkin (Mrs. M.A. "Morris")

* The seminar gathered together executives' wives to discuss the various problems, challenges, concerns, and [illegible] the company as a result of their experiences as spouses of senior management. As a result of the seminar, and their recommendations, F.W. McAbee may formulate special communications for executives and may forward his findings to Group level. This may be the first in a series of such special communication seminars.

Peg

OLD PORT YACHT CLUB

BEVERAGE CHECK

DATE	[illegible]	[illegible]	[illegible]	CHECK NO.
	W	Pety	5 C	52286

1/11 [illegible] 132.60

Tax 5.28

Svc 19.80

[illegible] 157.05

[illegible]

BEST COPY AVAILABLE

OLD PORT YACHT CLUB
BEVERAGE CHECK

		TABLE NO.	PERSONS	CHECK NO.
1/8	[illegible]			52288

128	Chardonnay	560.00
7	Merlot	84.00
	Wine	644.00
		25.76
		96.60
		$ 766.36

B&W Prog Fund

OLD PORT YACHT CLUB

BEVERAGE CHECK

DATE	SERVER	TABLE NO.	PERSONS	CHECK NO.
6/10				63292

1		
2	171 Dinners	342.00
3	14 Wine	18.00
4	24 Beer	30.00
5	74 Special	71.50
6		
7		461.50
8	Tx	18.46
9	Gr.	69.25
10		
11		549.21
12		

(15 PER CENT SERVICE INCLUDED)

MEMBER P+W [illegible] NO.

BEST COPY AVAILABLE

OLD PORT YACHT CLUB
DINING ROOM CHECK

DATE	SERVER	TABLE NO.	PERSONS	CHECK NO.
				1561

1			
2			
3			
4	11 Flower Arrangement		88.00
5		Tax	352
6		Dsc	3 00
7			
8		$	94.52
9			
10			
11			
12			

(15 PER CENT SERVICE INCLUDED)

MEMBER__________ NO.__________

BEST COPY AVAILABLE

OLD PORT YACHT CLUB

DINING ROOM CHECK

DATE	SERVER	TABLE NO	PERSONS	CHECK NO.
10/[illegible]/81		N/D/C	100	64276

1	86 Bar Canapes		301.00
2	100 Salmon Mousse (Lots from [illegible] count)		450.00
3	86 Roast Sirloin.		1075.00
4	86 Dessert + Coffee		279.50
5			
6			2015.50
7			80.62
8			302.35
9			
10			2398.47
11			
12			

(15 PER CENT SERVICE INCLUDED)

MEMBER RBW Playland NO.

BEST COPY AVAILABLE

OLD PORT YACHT CLUB

DINING ROOM CHECK

DATE	SERVER	TABLE NO.	PERSONS	CHECK NO.
10/21/81		NDR	50	64275

1			
2	50 Coffee + Danish		142.5
3	50 Luncheons		387.5
4			
5			530.
6			21.
7			74.8
8			
9		$	630.7
10			
11			
12			

(15 PER CENT SERVICE INCLUDED)

MEMBER RW Pyford NO.____

[illegible]

Internal Correspondence

To: Charlie Feeley
From: Peggy L. Ford
Subject: Attached Invoices
Date: 3 November 1981

Please pay the attached invoices promptly according to the following account and department numbers:

Dept. 100	Account 7498	$4,596.34 (Old Fort Cove)
Dept. 100	Account 7561	$1,835.87 (Connecticut Speakers Bureau)

Peggy L. Ford
Peggy L. Ford

99790
7498A
100

Remittance Advice

221592

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

2 132270 74984 000302 000 00 00021601 DC 2,220.36 .00
2,220.36 .00

Please Refer To Above Voucher Number When Making Inquiries	Net Voucher Total	$2,220.36

OPERATING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

58753

0 58753

VENDOR	DATE	VOUCHER
98201	03-03-81	221592

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

$2,220.36

PAY TO THE ORDER OF

NORTH PALM BEACH CATERING
508 INLET ROAD
NORTH PALM BEACH, FL 33408

AUTHORIZED SIGNATURE
NOT-NEGOTIABL
AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▸

BEST COPY AVAILABLE

[illegible]

North Palm Beach, Fla. 848-7183 [illegible]

M.L.H. J.S.J.
E.B.W. R.L.W.

To: Pratt + Whitney Corporation
Address P.O. Box 2691
City West Palm Beach, Fla Zip 33469

2/16/8

Hors d'oeuvres – Buffet	
Candy – Mixes – Glasses	
Waitresses – Bartender – Chef	
[illegible]	2139.00
Tax	85.56
	2224.56
McAbee Residence	
Sat. Feb. 14th 1981	
Thank You	DEPT. APPROVAL
	DEPT. NUMBER 100
	ACCOUNT NUMBER 7498A
	McAbee Staff Party

Bill Payable Upon Receipt of Bill.

BEST COPY AVAILABLE

[illegible]

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-7311

[illegible]	[illegible]	[illegible]	[illegible]
2 111300 J8006 900002	000 00	0010310[illegible] 01	2,200.00 2,200.00

[illegible] | [illegible] 02,200.00

PRATT & WHITNEY AIRCRAFT GROUP

[illegible]

Government Products Division
[illegible]

03188

[illegible]	[illegible]	[illegible]
98201	12-02-81	244447

02,200.00

NORTH PALM BEACH EXXON
501 INLET ROAD
NORTH PALM BEACH, FL 33408

NOT NEGOTIABLE

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To: Charlie Feeley Date: 11-19-

ok to pay:
Senior Staff Party
October 31-1981

Attendees: 30 people
(Vice presidents
and wives) Peg Fo.

PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

PWA 1113

[illegible]

OFFICE: 301 [illegible] Rd.
South Palm Beach, Fla.

848-7183

COMMISSARY: 1461 Old Dixie Hwy.
Riviera Beach, Fla.

CUSTOMER RELATIO

NOV 04 1981

J. S. J.
M. E. B.

To: Pratt & Whitney Corp.
Address P.O. Box 2691
City West Palm Bch, Fla Zip 33489

Nov 2, 1

Hot & Cold Hors d'oeuvres	
Hot Buffet	1150.00
Liquor-Wine-Beer	350.00
2 Waitresses - 1 Bartender	105.00
Rental Equip - Tent - Table Chairs etc.	591.86
2-Kitchen	N/C
Total	2196.86
Tax	83.68
Total	$2280.54
Thank You	

DEPT. APPROVAL x [illegible]
DEPT. NUMBER 100
ACCOUNT NUMBER 7498 - Miscellaneous Sundry Exp.

Senior Staff Halloween party

Bill & Carol Albert Brecknon's House 10/31/81

Bill Payable Upon Receipt of Bill.

BEST COPY AVAILABLE

PRATT & WHITNEY AIRCRAFT GROUP

1985 6

[illegible]

[illegible]

[illegible] 1980

PRATT & WHITNEY AIRCRAFT GROUP

93122

[illegible]

[illegible]

NOT-NEGOTIABLE

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PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

Internal Correspondence

To: Clark MacGregor
From: W. T. Dwyer
Subject: 1980 Florida Campaign Contributions
Date: 26 November 1979

Summary

It is recommended that a budget of $7500 be established by GPD, Otis and Sikorsky for direct contributions to state and county candidates in 1980.

Law

Direct corporate contributions to Florida Political campaigns are permissable under Section 106, laws of Florida.

There are no reporting requirements for the corporate contributor. Maximum contributions to a candidate in one election are $3000 for statewide offices, $2000 for District Court of Appeal judges, and $1000 for all county, multi-county and legislative offices. 1st and 2nd Primaries and General Elections are each deemed separate elections.

Offices up for election in 1980:

The following State and county offices will be filled by election in 1980:

Senators (Odd numbered districts)
House of Representatives (all districts)
State Attorney
Public Defender
Clerk of the Circuit Court
Sheriff
Property Appraiser
Tax Collector
Supervisor of Elections
3 County Commissioners (Odd numbered districts)
3 School Board members
2 Circuit Court judges
4 County Court judges
5 Supreme Court justices
1 Appeals Court judge

A listing of the incumbents in those offices is attached as Exhibit A.

1980 Election dates:

March 11 – Presidential Preference Primary
July 9-22 – Qualifying period
Sept. 9 – 1st Primary
Oct. 7 – 2nd Primary
Nov. 4 – General Election

Budget Recommendation:

It is recommended that a budget of $7500 be established to be expended for the following offices:

Florida Senate	$1000
Florida House of Representatives	$2750
State Attorney	250
Sheriff	500
Property Appraiser	500
Supervisor of Elections	250
County Commission – Palm Beach County	1000
– Martin County	500
School Board	750
	$7500

Funds set aside but not expended for any of the above offices will be considered available for other offices, if needed.

Due to the presence of other UTC Divisions in Palm Beach County, it is recommended that this budget be shared as follows:

GPD	$5500	73%
Sikorsky	1000	13%
Otis	1000	13%

Administration:

It is recommended that all requests for contributions be reviewed by a committee composed of the following personnel:

W. T. Dwyer, V.P., GPD, Chairman
L. W. Clarkson, V.P. Marketing, GPD
W. S. Parker, V.P. Division Counsel, GPD
G. David, V.P. LAO, Otis
J. Islin, Director, Development Flight Test
Center, Sikorsky

Committee recommendations will be endorsed by Frank W. Hubben, President, GPD and forwarded to Clark MacGregor, Sr. V.P., UTC for review and approval prior to disbursement.

W T Dwyer
W. T. Dwyer, Jr.

WTD/mej

Approved:
Frank W. [illegible]

W. T. DWYER
AUG 13 1980

C. MacGREGOR
AUG 11 1980

PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

Internal Correspondence

To: Clark MacGregor
From: W. T. Dwyer
Subject: 1980 Florida State Campaign Contributions
Copy to: Frank W. McAbee, Jr.
Date: August 1, 1980

The qualifying period for the 1980 Florida election expired July 22, 1980. A list of the candidates who qualified for offices of interest to UTC in the Palm Beach, Broward, and Martin County areas is attached.

The committee, consisting of representatives from GPD, Sikorsky, and Otis, met on August 1 and endorsed initial contributions to the following candidates:

SENATE Dist. 27	T. Lewis (R)	$1,000
HOUSE OF REPRESENTATIVES Dist. 78	R. Liberti (D)	$250
Dist. 87	J. Watt (R)	$250
Dist. 82	B. Kimmel (R)	$500
SHERIFF	R. Wille (R)	$250
SUPERVISOR OF ELECTIONS	J. Winchester (D)	$250
PALM BEACH COUNTY COMMISSION Dist. 5	D. Bailey (R)	$250
PALM BEACH COUNTY SCHOOL BOARD Dist. 1	P. Neesmith	$100

On the remaining contested offices, the committee voted to withhold support pending either the outcome of the primary races or the development of further background information on the candidates.

Your early concurrence in the above recommendations is requested so that the contributions may be provided the candidates as early as possible in their campaigns.

W T Dwyer
W. T. Dwyer

Approved and Forwarded: F W McAbee
Frank W. McAbee, Jr.

Approved: Clark MacGregor

PRATT & WHITNEY AIRCRAFT GROUP
Government Products Division

Internal Correspondence

To: F. Aitken
From: W. T. Dwyer
Subject: 1980 Florida Campaign Contributions
Copy to: L. W. Clarkson, J. Iselin,
W. Fusher, A. Garton
Date: August 19, 1980

V/C# 48/21
A/C#
DEPT.#

Contributions from the GPD/Sikorsky/Otis campaign account have been approved at Divisional and Corporate levels per the attached memorandum. Please draw checks in the following amounts and forward to me for transmittal to the candidates.

Candidate	Amount
Thomas F. Lewis Campaign Fund	$1,000.00
Ray Liberti Campaign Fund	$250.00
Jim Watt Campaign Fund	$250.00
Bernard Kimmel Campaign Fund	$500.00
Richard Willis Campaign Fund	$250.00
Jackie Winchester Campaign Fund	$250.00
Bill Bailey Campaign Fund	$250.00
Paula Nesmith Campaign Fund	$100.00

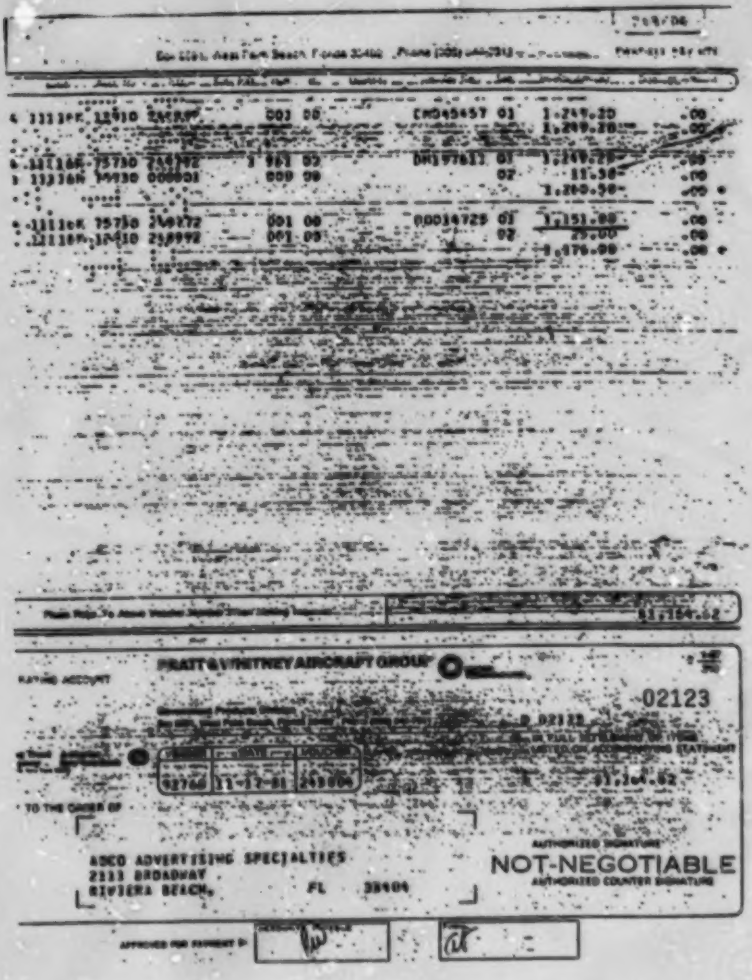
The cost associated with these contributions should be allocated among the respective divisions in accordance with my memo of 26 November 1979.

WTDwyer
W. T. Dwyer

WTD/cej

Attachments

BEST COPY AVAILABLE



Box 2691, West Palm Beach, Florida 33402 Phone (305)

```
1111 10K 12910 2?????          001 00          CM049457 01    1,249.20      .00
                                                              1,249.20-     .00
1111 10K 75730 2?????        3 001 00          DM1 97611 01   1,249.20-     .00
1111 10K 14930 000001          000 00                   02       11.30-     .00
                                                              1,260.50-     .00 *
1111 10K 75730 2?????          001 00          00014725 01    1,151.00      .00
1111 10K 12910 2?????          001 00                   02       25.00      .00
                                                              1,176.00      .00 *
```

$1,264.82

PRATT & WHITNEY AIRCRAFT GROUP

PAYING ACCOUNT

02123

Government Products Division

D 02123

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

02766	11-17-81	243???

$1,264.82

TO THE ORDER OF

ADCO ADVERTISING SPECIALTIES
2111 BROADWAY
RIVIERA BEACH, FL 33404

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶

BEST COPY AVAILABLE

ADC 2111 BROADWAY • RIVIERA BEACH, FLORIDA 33404 • PHONE [illegible]

DATE September 2, 1981

SOLD TO PRATT & WHITNEY AIRCRAFT GROUP
Government Products Div.
P.O. Box 2691
West Palm Beach, Fl. 33402

YOUR ORDER NO. ~~[illegible]~~

TERMS NET 10 DAYS

	DESCRIPTION	AMOUNT
3/M	11" BALLOONS-ASST COLORS (NO WHITE) 2-4771 @ 94.18/M	941.80
1/M	16" BALLOONS-ASST COLORS (NO WHITE) @ 209.20/M	209.20
		1151.00
	CUSTOM PLATE CHG 1-5-4771	25.00

* Pd. under ---

②

RECEIVED
SEP 8 1981
TREASURY DEPT.

TOTAL	1,176.00
4% SALES TAX	
SHIPPING F.O.B. FACTORY	
TOTAL AMOUNT DUE	$1,176.00

PLEASE PAY THIS INVOICE • WE DO NOT SEND STATEMENT

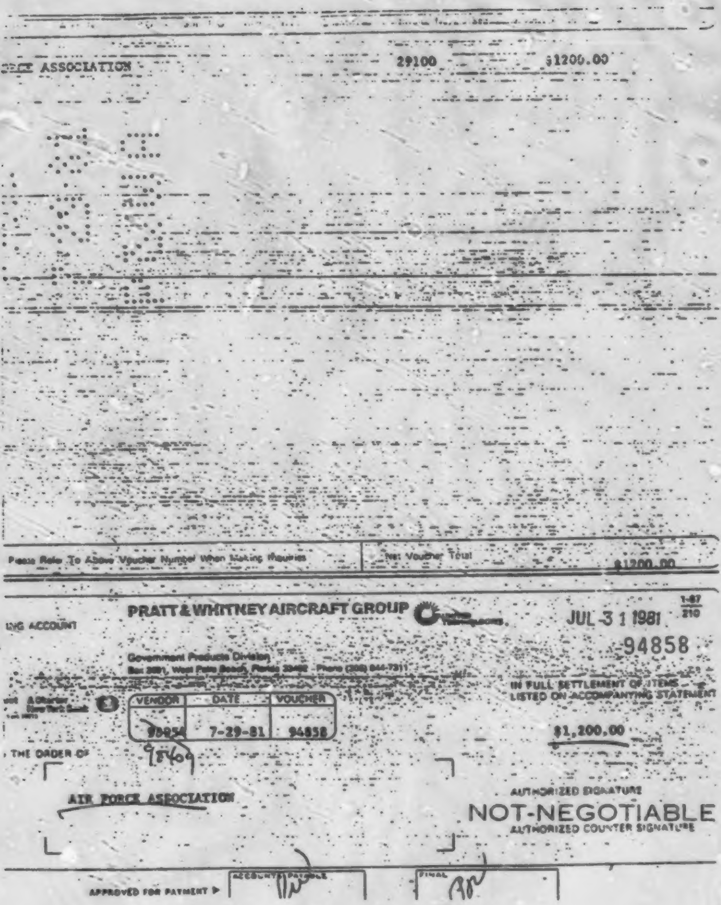
DEBIT MEMORANDUM
EXTENSIONS VERIFIED J

V

Requested by: [illegible]

Any discrepancy must be reported in writing to the Purchasing Department within two weeks following date of Shipment to you.

XXX UPS. 11.38	NUMBER OF CONTAINERS	GROSS WEIGHT
[illegible]	TYPE OF CONTAINER	INSPECTED BY
[illegible]	FREIGHT BILL NUMBER	



ASSOCIATION 29100 $1200.00

Please Refer To Above Voucher Number When Making Inquiries | Net Voucher Total $1200.00

ING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 · Phone (305) 840-7311

JUL 3 1 1981

1-87
210

94858

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
98056	7-29-81	94858

98409

THE ORDER OF

AIR FORCE ASSOCIATION

$1,200.00

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶ ACCOUNTS PAYABLE | FINAL

[illegible]

FROM: Joe Jaswinski EXT. 2429

DATE: 7/27/81

••

Would you please request a check as follows:

AMOUNT: $1,200.00

ISSUED TO: Air Force Association

FOR: Two (2) tables - Dinner Dance, Sept. 16, 1981 - AFA National Convention

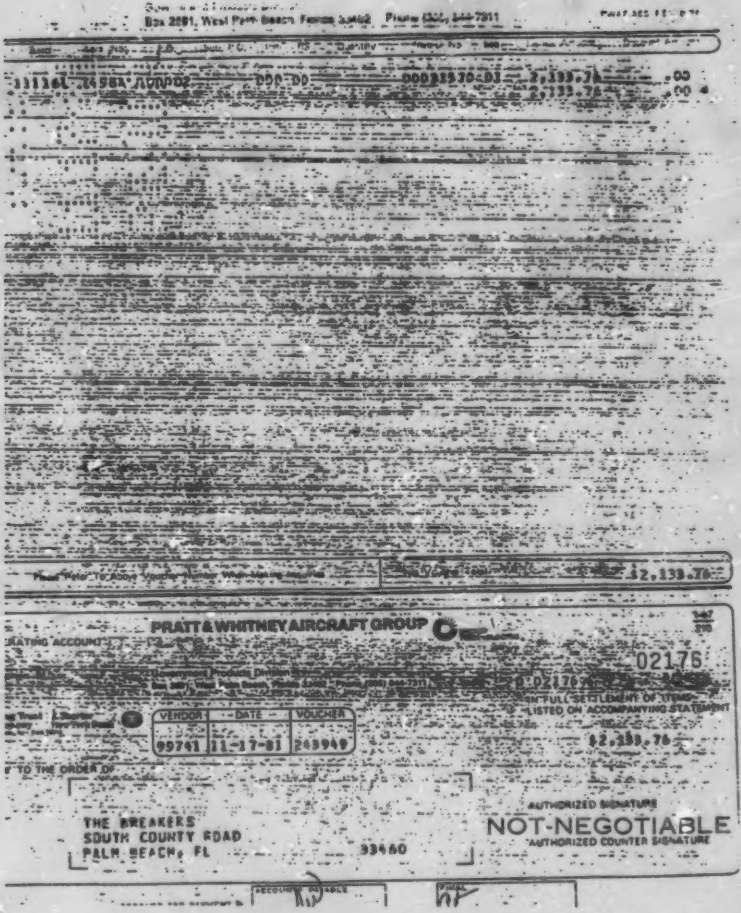
CHARGE TO: DEPT. NO. 802 / ACCT. NO. 7498

Please return this check to Customer Relations (483) for transmittal.

02-5

APPROVED KEK

BEST COPY AVAILABLE



Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

111161 24584 AUNP02 000 00 00033570 01 2,133.76 .00

2,133.76 .00

Please Refer To Above Voucher Number When Making Inquiries

$2,133.76

PRATT & WHITNEY AIRCRAFT GROUP

ATING ACCOUNT

02176

Government Products Division

Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

02176

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
99741	11-17-81	243949

$2,133.76

TO THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

ACCOUNTS PAYABLE

FINAL

BEST COPY AVAILABLE

24

The Breakers
Palm Beach, Florida 33480
Phone (305) 655-6611

DATE [illegible]

CUSTOMER RELATIONS
OCT 15 1981
L.S.J.
K.R.M. E.G.W.

WE ARE PLEASED TO CONFIRM ROOM RESERVATIONS AS INDICATED BELOW.

RESERVATION NO. 0802510

PRATT & WHITNEY

GUEST	M/M ROBERTO DE LA ROCHA
ARRIVAL	FRI OCT 09,1981
DEPARTURE	WED OCT 14,1981
ACCOMMODATIONS	1 DELUXE ROOM
NUMBER OF PERSONS	2 PERSONS MODIFIED AMERICAN PLAN
RATE AND PLAN	150.00 PER DAY PLUS SERVICE CHARGE AND TAX
REMARKS	DELUXE ROOM, OK TO BILL DIRECT PER MS SCHIFFINO

* [illegible] Lilly,
the approval
signatures
account for entire
bill attached

DEPT. APPROVAL	x [illegible]
DEPT. NUMBER	846
ACCOUNT NUMBER	7498
De la Rocha visit	

GPD A.P.
[illegible] 12 1981
EXT.

R.E. Lamm
ROBERT E LAMM
[illegible]

$2,133.76

PRATT & WHITNEY
P O BOX 2691 & 03
WEST PALM BEACH FL 32402

NOTICE - [illegible]

[illegible]

The Breakers

CUSTOMER RELATIONS

PRATT WHITNEY
ATTN ERNIE WRIGHT
P O BOX 2691
WEST PALM BEACH FL 33402

OCT 30 1981

J. W. J.
R. K. M. E. D. W.

1	33570		0900
10/08/81			10/14/81
EP			A
.00	.00		.00
			1
			A21

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

REFERENCE		DESCRIPTION		CHARGES	CREDITS
10/12	311-010	BANQ FUNC FOOD 10/10		276.27	
10/12	311-011	BANQ FUNC FOOD 10/10		365.97	
10/12	319-001	ALCAZAR BAR 10/10		35.08	
10/12	319-002	ALCAZAR BAR 10/10		30.50	
10/12	364-012	LABOR CHARGE 10/10		90.00	
10/13	325-005	BANQ FUNC BEV. 10/10		107.76	
10/13	325-006	BANQ FUNC WINE 10/10		222.46	
10/13	346-002	FLOWER SHOP		52.00	
10/13	364-003	BARTENDER 10/10		35.00	
10/15	501-002	DE LA ROCHA 10/14	* 544709	* 957.92	room charge!

AMOUNT DUE ▶ * 2,133.76

222

222

[illegible] CUSTOMER RELATIONS [illegible]
MR ERNIE WRIGHT
PRATT & WHITNEY
WEST PALM BEACH FL

OCT 30 1981

150.00	15.00	6.40

J. S. J.
R. A. M. E. B. W.

C34

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

10/09		ROOM CHARGE	171.60
10/10		ROOM CHARGE	171.60
10/10	338-031	TELEPHONE LONG DIST.	3.25
10/10	338-032	TELEPHONE LONG DIST.	4.25
10/11		ROOM CHARGE	171.60
10/11	306-029	C/R SURCHARGE 10/11/81	7.18
10/11	307-039	FOOD-ROOM SERVICE	3.64
10/11	312-030	BEVERAGE DINING RM	3.00
10/11	338-090	TELEPHONE LONG DIST.	18.65
10/11	338-104	TELEPHONE LONG DIST.	2.90
10/11	338-109	TELEPHONE LONG DIST.	2.90
10/12		ROOM CHARGE	171.40
10/12	334-007	LAUNDRY	17.37
10/13		ROOM CHARGE	171.60
10/13	306-001	FOOD-DINING ROOM	4.99
10/13	338-044	TELEPHONE LONG DIST.	18.15
10/14	307-034	FOOD-ROOM SERVICE	3.64

room charge

CHARGES INCURRED ON YOUR DAY OF DEPARTURE MAY NOT BE REFLECTED ON [illegible] TO YOU [illegible] CHARGES

AMOUNT DUE ▶ 957.92

[illegible]

The Breakers

BEST COPY AVAILABLE

BUSINESS GUEST REPORT DOCUMENTATION

DATE	NAME	TITLE	AFFILIATION	BUSINESS TOPIC
	F. d. l. Rocha	Director	Rigen Co	Spanish Program
	P. de la Rocha	Director	Rigen Co.	FACA
	R. Frazier		P&WA/GPD	
	D. Frazier			
	A. Schofield			
	L. Wenzel			
	C. Wenzel			
	E. Castro			
	M. Castro			
	S. Huggins			
	L. Huggins			
	R. Musselwhite			
10/16	F. de la Rocha		Rigen Co.	
	P. de la Rocha		Rigen Co.	

Remittance Advice

210919

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

[illegible]

C T	[illegible]	Acct. No.	P.O.	Sub P.O.	Item	[illegible]	Quantity	Invoice No.	Seq.	Invoice Amount	Discount Amount
2	10127N	7598A	000062		000	00		00031753	01	2,280.05	.00
	10127N	73200	000050		000	00			02	1,520.02	.00
										3,800.07	.00

P&WA

Please Refer To Above Voucher Number When Making Inquiries	Net Voucher Total $3,800.07

OPERATING ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 840-2311

D 65819 65819

Vendor	Date	Voucher
99741	01-30-81	210919

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

$3,800.07

PAY TO THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶

BEST COPY AVAILABLE

PRATT & WHITNEY RECEPTION
MR BOB WALDROP
P O BOX 2691-A R3
WEST PALM BEACH FL 32402

1/02/81 1/09/81
FP 4
.00 .00 .00
1
A12

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

DATE	REFERENCE	DESCRIPTION	CHARGES	CREDITS
1/07	319-073	BEVERAGE ALCAZAR	11.00	
1/08	311-005	BANQ/FUNC FOOD 01/07	1808.35	
1/09	311-005	BANQ FUNC FOOD 01/07	717.60	
1/09	325-009	BANQ FUNC BEV. 01/07	307.07	
1/09	325-010	BANQ FUNC BEV. 01/07	209.19	
1/09	325-011	BANQ FUNC WINE 01/07	399.46	
1/09	364-010	ATTENDANTS	25.00	A/P
1/10	346-020	FLOWER SHOP	[illegible]	

Deposit sent to Bank

CUSTOMER RELATIONS
JAN 1 8 1981
M.L.H. J.S.J.
E.B.W. R.L.W.

1-19-81

DEPT. APPROVAL	x
DEPT. NUMBER	# 540
ACCOUNT NUMBER	# 749-A 60% 7528 40%

Co-production Prom.
Conducting Expense

CHARGES INCURRED ON YOUR DAY OF DEPARTURE MAY NOT BE REFLECTED ON THIS STATEMENT. AN INVOICE WILL BE MAILED TO YOU FOR SUCH DAY OF DEPARTURE CHARGES.

AMOUNT DUE 3,800.07

ALL ACCOUNTS CHARGED ARE DUE UPON PRESENTATION OF YOUR BILL. [illegible] OF A FINANCE CHARGE. THE FINANCE CHARGE WILL BE APPLIED TO THE PORTION OF THE PREVIOUS BALANCE [illegible] COMPUTED AT THE RATE OF [illegible] PER MONTH. THIS IS AN ANNUAL PERCENTAGE RATE OF [illegible]. ALL PAYMENTS [illegible] PREVIOUS BALANCE PRIOR TO THE COMPUTATION OF THE FINANCE CHARGE.

The Breakers
Palm Beach, Florida

BEST COPY AVAILABLE

[illegible]

No. [illegible]30

CHARGE

ROOM OR A-C NO. 3 1 7 5 3

ID P R

☑ GUEST
☐ CITY LEDGER

DATE 1/7/1

PRINT NAME CLEARLY: PRATT & WHITNEY

AMOUNT 2.00

DESCRIPTION TO APPEAR ON STATEMENT: XTRA LABOR

EXPLANATION

1 Attendant for Steak Carture station @ $25.00 | 25.00

Credit to 110-8[illegible] | 25.00

2026 M/35
Rev. 8/77

PREPARED BY Maria C. [illegible]
SIGNATURE

227

227

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BLANK PAGE

BLANK PAGE

CHARGE

ROOM OR A/C NO. 3 1 7 5 3

ID

☐ GUEST
☐ CITY LEDGER

DATE 1/18/[illegible]

PRINT NAME CLEARLY: Pratt-Whitney

AMOUNT	$ 31[illegible]	[illegible]
TAX	$ 1[illegible]	40
TOTAL	$ 32[illegible]	40

EXPLANATION Flowers on hors d'oeuvres table 75.00
17 round tables - Pink linen 235
Special Bows 310
Magnolia

3716 M/54
JUNE 77

PREPARED BY ______________________
SIGNATURE

BANQUET / FUNCTION WINE

12 -

DATE	SERVER	TABLE NO.	PERS				CHECK NO.
1/7/81	Rk					Magnolia	0667

1		
2		
13	3 #797 @ 16.00	208.0
	4	
7	5 # 749 @ 18.00	126.0
	6	
	7	
	8	
	9	
	10	
	11	
	12	
	13	
	14	

S
SC 157
TX 47
T

PLEASE PRINT NAME

SUB-TOTAL	334.
SERVICE CHARGE	50.
STATE TAX	15.
TOTAL	399.

Pratt + Whitney
GUEST SIGNATURE

ROOM-ACCT
3175

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO

DATE | THE BREAKERS RECEIPT | AMOUNT | CHECK 0667

DATE | WAITER'S RECEIPT DO NOT PAY | AMOUNT | CHECK 06679

BEST COPY AVAILABLE

BANQUET/FUNCTION BEVERAGE

DATE	SERVER	TABLE NO.	PERS			CHECK
1/7/81	AA				Magnolia	1282

Cordials	174.9

BB

	SUB-TOTAL	174.
15%	SERVICE CHARGE %	26.
4%	STATE TAX	8.0
PLEASE PRINT NAME	TOTAL	209.

Pratt + Whitney

GUEST SIGNATURE

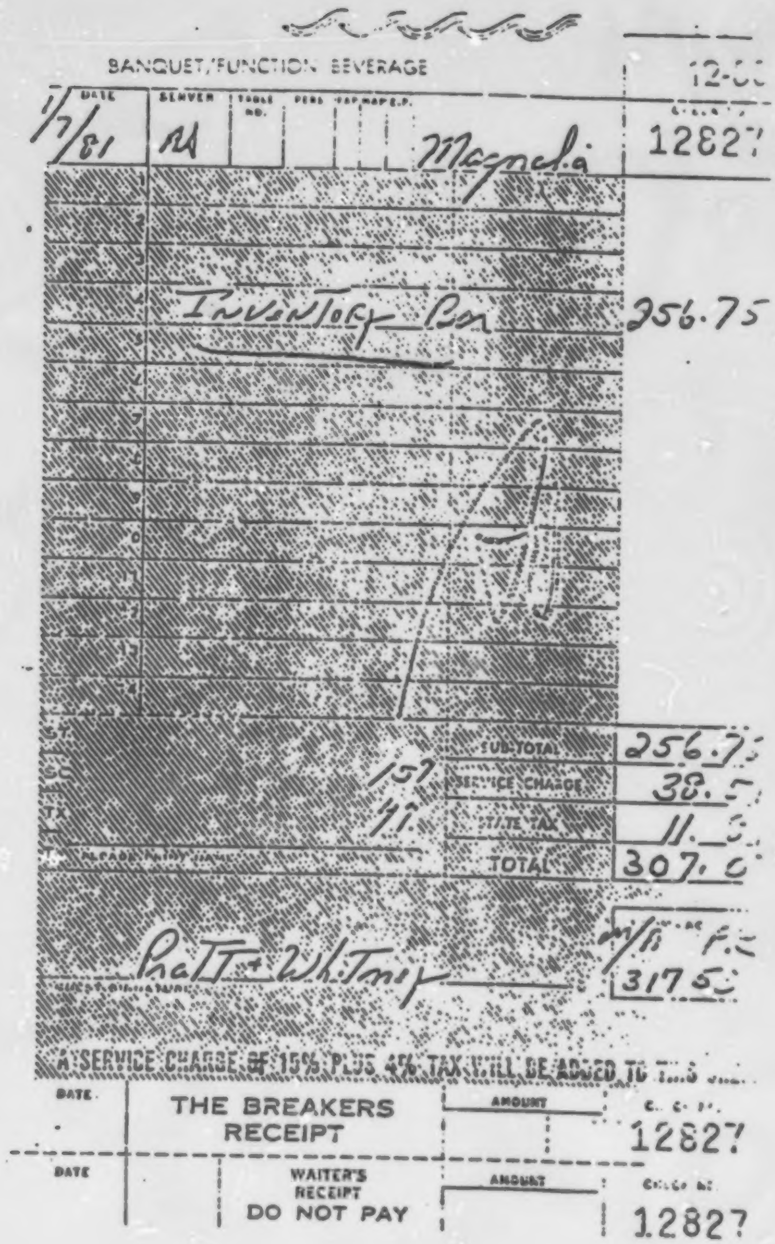
31153

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS

DATE		AMOUNT	CHECK
	THE BREAKERS RECEIPT		12828

DATE		AMOUNT	CHECK
	WAITER'S RECEIPT DO NOT PAY		1282

BEST COPY AVAILABLE



BANQUET/FUNCTION BEVERAGE

12-0

DATE 1/7/81

Magnolia

12827

Inventory Bar 256.75

SUB-TOTAL	256.7
15% SERVICE CHARGE	38.5
4% STATE TAX	11.
TOTAL	307.0

Pratt + Whitney

3175

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS

DATE

THE BREAKERS RECEIPT

AMOUNT

12827

DATE

WAITER'S RECEIPT DO NOT PAY

AMOUNT

12827

BEST COPY AVAILABLE

BANQUET FUNCTION FOOD

DATE	SERVER	TABLE NO.	PERS		CHECK NO.
4/7/81	Marie	153/53		Magnolia 2-rm	303

1	BUFFET		
1	2 Cheese board @	$75.00++	75.
1	3 crudités @	$35.00++	35.
3	4 lbs Steak Tartare @		60.
	5 $20.00 per lb++		
100	6 Shrimps @ $125.00++		125.
100	7 Crab Claws @ $175.00++		175.
100	8 Rumakis @ $70.00++		70.
100	9 Teriyaki @ $60.00++		60.
	10		
	11		
	12		
	13		

FOOD	600.
BEVERAGE	—
SERVICE CHARGE	90.
STATE TAX	[illegible]
TOTAL	71[illegible]

BY

SC PRATT & WHITNEY 15%

TX 4%

T PLEASE PRINT NAME

M/A # ROOM ACCT 31753

GUEST SIGNATURE

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS [illegible]

DATE THE BREAKERS RECEIPT AMOUNT 303

DATE WAITER'S RECEIPT DO NOT PAY AMOUNT 303

BEST COPY AVAILABLE

BANQUET FUNCTION FOOD

1[illegible]-[illegible]

DATE	SERVER	TABLE NO.	PERS.		CHECK NO.
1/7/81	Marie		53/53	MAGNOLIA ROOM	303[illegible]

1 BUFFET

2

56 3 Dinners @ $ 24.50 ++ 1372.0-

56 4 Baked Alaska @ $ 2.50 ++ 140.0-

5

6 ACTUAL 52

7

8 Quantity = 56

9

10

11

12

13

F

BV

SC PRATT & WHITNEY 15

TX 4

T. PLEASE PRINT NAME

FOOD	1,51[illegible]
BEVERAGE	—
SERVICE CHARGE	226.[illegible]
STATE TAX	6[illegible]
TOTAL	1,8[illegible]

M/A # 31[illegible]

GUEST SIGNATURE

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

DATE

THE BREAKERS
RECEIPT

AMOUNT

303[illegible]

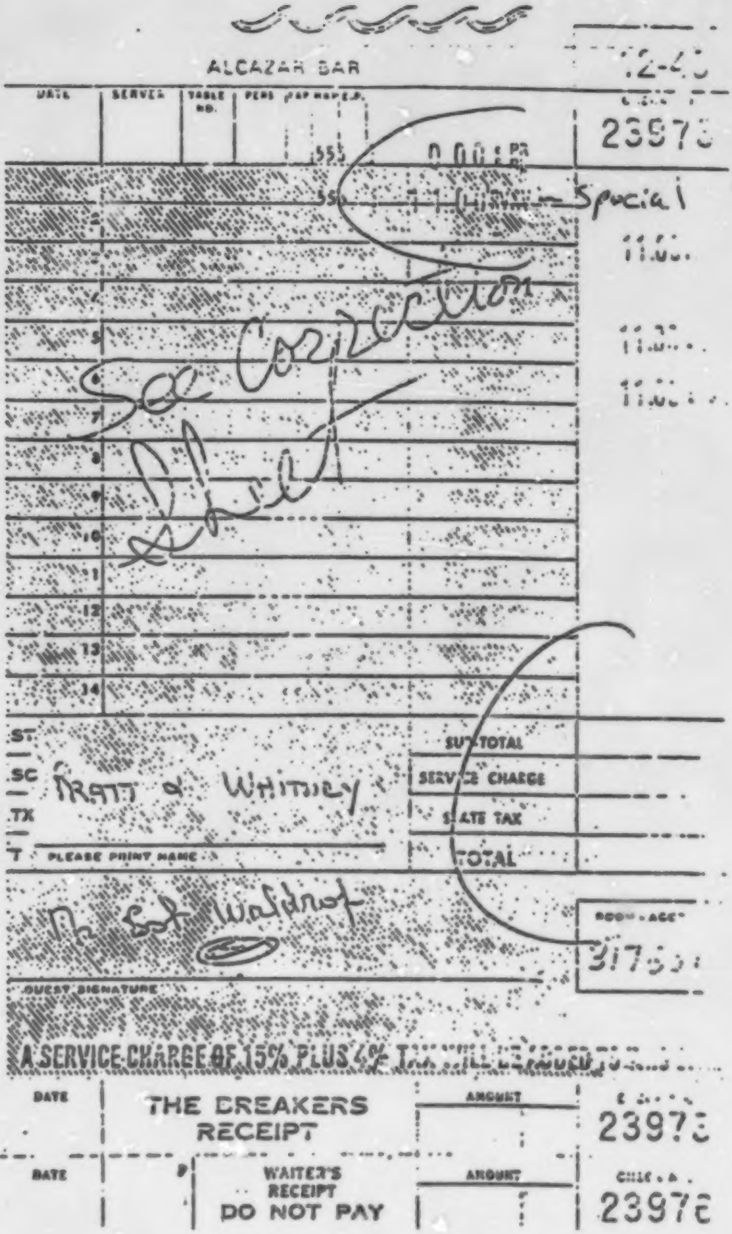
DATE

WAITERS
RECEIPT
DO NOT PAY

AMOUNT

303[illegible]

BEST COPY AVAILABLE



ALCAZAR BAR

12-4

DATE | SERVER | TABLE NO. | PERS

2397

555

Special

11.00

11.30

11.00

See Correction Sheet

ST

SC Pratt & Whitney

TX

T PLEASE PRINT NAME

SUBTOTAL

SERVICE CHARGE

STATE TAX

TOTAL

Waldrof

GUEST SIGNATURE

ROOM - ACCT

317

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED

DATE

THE BREAKERS
RECEIPT

AMOUNT

2397

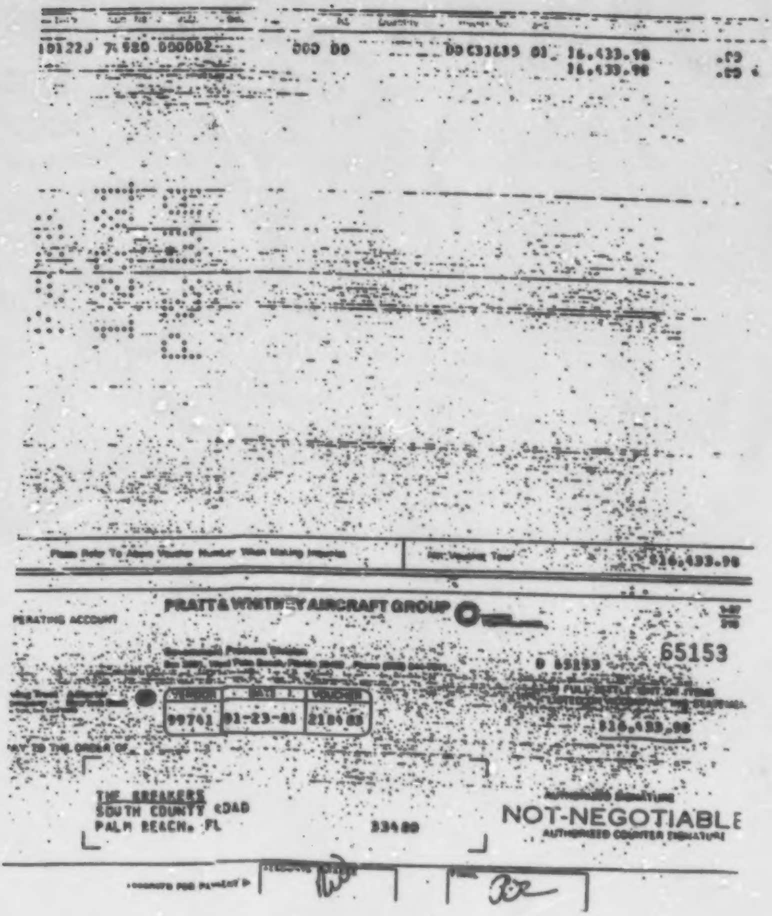
DATE

WAITER'S
RECEIPT
DO NOT PAY

AMOUNT

2397

BEST COPY AVAILABLE



10122J 74980 000002 000 00 00C33635 01 16,433.98 .00

16,433.98 .00

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $16,433.98

PRATT & WHITNEY AIRCRAFT GROUP

PERATING ACCOUNT

Government Products Division

65153

0 65153

VENDOR	DATE	VOUCHER
99741	01-23-81	210483

$16,433.98

AY TO THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT

BEST COPY AVAILABLE

MS GAIL W [illegible]
P O BOX 261
WEST PALM BEACH FL 33402

.00 .00
1
625

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

DATE	REFERENCE	DESCRIPTION	CHARGES	CREDITS
12/15	501-035	DEP P & W EXEC MGMT * 31012		750.00
12/17	311-028	BANQ/FUNC FOOD 12/16	10912.50	
12/17	311-029	BANQ/FUNC FOOD 12/16	130.00	
12/19	325-002	BANQ/FUNC BEV 12/16	5451.01	
12/19	325-003	BANQ/FUNC WINE 12/16	637.47	
12/23	501-043	FLOWER.SHOP * 31633	52.00	

Approved: 1/16/81
Dept. 100, Acct. 7498

GPD A/P
JAN 21 1981
EXT.

CHARGES INCURRED ON YOUR DAY OF DEPARTURE MAY NOT BE REFLECTED ON THIS STATEMENT. AN INVOICE WILL BE MAILED TO YOU FOR SUCH DAY OF DEPARTURE CHARGES.

AMOUNT DUE 16,433.98

ALL AMOUNTS CHARGED ARE DUE UPON PRESENTATION OF YOUR BILL. FAILURE TO PAY FOR 60 DAYS AFTER THE DUE DATE WILL RESULT IN THE IMPOSITION OF A FINANCE CHARGE. THE FINANCE CHARGE WILL BE APPLIED TO THE PORTION OF THE PREVIOUS BALANCE MORE THAN 60 DAYS OLD AND WILL BE COMPUTED AT THE RATE OF 1½% PER MONTH. THIS IS AN ANNUAL PERCENTAGE RATE OF 18%. ALL PAYMENTS AND CREDITS ARE DEDUCTED FROM THE PREVIOUS BALANCE PRIOR TO THE COMPUTATION OF THE FINANCE CHARGE.

The Breakers
Palm Beach, Florida

99741
7498
100

12/11/80 RA Vacation 12538

Inventory - Bar 4557.70

	SUB-TOTAL	4557.70
15%	SERVICE CHARGE	683.66
4%	STATE TAX	209.65
	TOTAL	5451.01

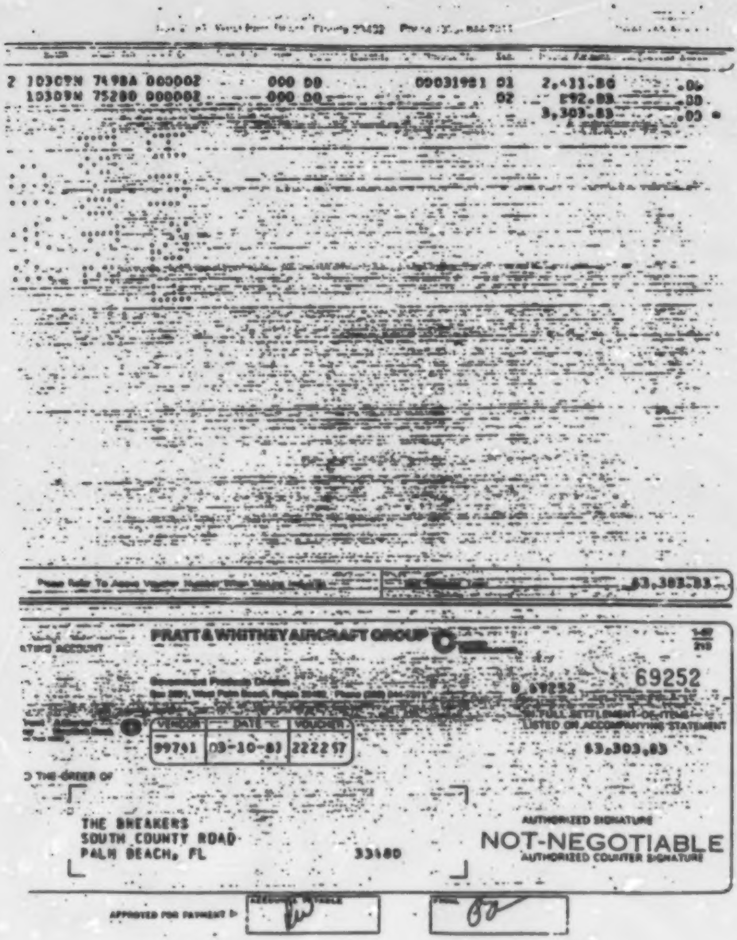
Bryant Hill Esq

CH. ACCT. 31635

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK.

DATE	THE BREAKERS RECEIPT	AMOUNT	CHECK NO. 12538
DATE	WAITER'S RECEIPT DO NOT PAY	AMOUNT	CHECK NO. 12538

BEST COPY AVAILABLE



2	10309N	7498A	000002	000 00	00031981	01	2,431.80
	10309N	75280	000002	000 00		02	892.03
							3,303.83

Please Refer To Above Voucher Number When Making Inquiry — $3,303.83

ATIVE ACCOUNT

PRATT & WHITNEY AIRCRAFT GROUP

Government Products Division

69252

D 69252

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
99741	03-10-81	222257

$3,303.83

THE ORDER OF

THE BREAKERS
SOUTH COUNTY ROAD
PALM BEACH, FL 33480

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▷

BEST COPY AVAILABLE

CUSTOMER RELATIONS

PRATT & WHITNEY
JOAN HOLK
P O BOX 2691-AP7
WEST PALM BEACH FL 334[illegible]

FEB 27 1981

M.L.H. J.S.L.
C.B.W. R.L.W.

.00 .00

130

PLEASE RETURN THIS TOP PORTION WITH YOUR REMITTANCE

DATE	REFERENCE	DESCRIPTION	CHARGES	CREDITS
2/20	311-010	BANC/FUNC FOOD 02/19	844.37	
2/20	311-016	BANC/FUNC FOOD 02/19	1230.68	
2/20	325-010	BANC/FUNC WINE 02/19	375.31	
2/20	325-023	BANC/FUNC BEV. 02/19	120.44	
2/20	325-014	BANC/FUNC BEV. 02/19	302.83	
2/20	346-007	FLOWER SHOP	395.20	
2/20	364-007	EXTRA LABOR 02/19	30.00	
2/20	364-017	BARTENDER	35.00	

DEPT. APPROVAL	x S. Bettich
DEPT. NUMBER	130
ACCOUNT NUMBER	7498H 73% 7529 27%

PL01120 Design Review Israel & Sweden

$3,303.83

GPD A/P
MAR - 6 1981
ENT.

CHARGES INCURRED ON YOUR DAY OF DEPARTURE MAY NOT BE REFLECTED ON THIS STATEMENT. AN INVOICE WILL BE MAILED TO YOU FOR SUCH DAY OF DEPARTURE CHARGES.

AMOUNT DUE ▶ 3,303.83

ALL AMOUNTS CHARGED ARE DUE UPON PRESENTATION OF YOUR BILL. FAILURE TO PAY FOR [illegible] DAYS AFTER THE DUE DATE WILL RESULT IN THE [illegible] OF A FINANCE CHARGE. THE FINANCE CHARGE WILL BE APPLIED TO THE PORTION OF THE PREVIOUS BALANCE MORE THAN [illegible] DAYS OLD AND IS COMPUTED AT THE RATE OF 1½% PER MONTH. THIS IS AN ANNUAL PERCENTAGE RATE OF 18%. ALL PAYMENTS AND CREDITS ARE DEDUCTED FROM PREVIOUS BALANCE PRIOR TO THE COMPUTATION OF THE FINANCE CHARGE.

The Breakers
Palm Beach, Florida

BEST COPY AVAILABLE

MISCELLANEOUS CHARGE

DEPT. CODE 80-90

Nº 3

CHARGE

ROOM OR A/C NO. 31581	ID PR	☑ GUEST ☐ CITY LEDGER	DATE 2/19/
PRINT NAME CLEARLY: PRATT & WHITNEY		AMOUNT	$ 3

DESCRIPTION TO APPEAR ON STATEMENT: BARTENDER

EXPLANATION: MAR20

120-8210

18:08

Rev. 3/77

PREPARED BY Bob [illegible]
SIGNATURE

MISCELLANEOUS CHARGE

DEPT. CODE 80-90

Nº 253

CHARGE

ROOM OR A/C NO. 031981	ID PR	☑ GUEST ☐ CITY LEDGER	DATE 2/19/
PRINT NAME CLEARLY: PRATT & WHITNEY		AMOUNT	$ 50

DESCRIPTION TO APPEAR ON STATEMENT: XTRA LABOR

EXPLANATION: MAR20

2 Attendants for Intimates

Shows @ $25.00 ea — $50

10:08

FLOWER SHOP

DEPT. CODE	70-25
Nº	
CHARGE — ROOM OR A/C NO.	2 3 7 1 8 1
ID	✓ ✓
☑ GUEST	
☐ CITY LEDGER	
DATE	2/2
PRINT NAME CLEARLY	[illegible]
AMOUNT	3
TAX	
TOTAL	3

EXPLANATION:

6 [illegible]	240.00
1 [illegible]	90.00
1 [illegible]	
	380.00

2716 JUNE 77 PREPARED BY SIGNATURE

The Breakers
Palm Beach Florida

BANQUET/FUNCTION BEVERAGE

CODE	12-80
CHECK NO.	15101
Mog	
Inventory Bar	253.20
SUB TOTAL	253.20
SERVICE CHARGE	37.98
STATE TAX	11.65
TOTAL	302.83
B. W	31981

CE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK

THE BREAKERS	AMOUNT	CHECK NO

BEST COPY AVAILABLE

The Breakers
Palm Beach, Florida

BANQUET / FUNCTION WINE

12-81

CHECK NO. 00252

1/2 Magnolia

[illegible]	10	16.00	160.00
[illegible]	7	16.00	112.00
		SUB-TOTAL	272.00
	15%	SERVICE CHARGE	40.80
	4%	STATE TAX	12.51
		TOTAL	325.31

ct 4 Whitney

17A PR
3/19/81

The Breakers
Palm Beach, Florida

BANQUET/FUNCTION BEVERAGE

12-80

CHECK NO. 15102

2/19 Ma

[redacted]

	100.70
	100.70
	15.11
	4.63
	120.44

BEST COPY AVAILABLE

The Breakers
Palm Beach, Florida

BANQUET FUNCTION FOOD

11-80

MAGNOLIA ROOM

3940

BUFFET

[illegible] @ 1.50	[illegible]	63.00
[illegible] @ 19.50	[illegible]	399.00
[illegible]		24.00
[illegible]	[illegible]	25.00
[illegible]		195.00

[illegible] WHITNEY 15%
4%

FOOD	706.00
BEVERAGE	—
SERVICE CHARGE	105.90
STATE TAX	32.47
TOTAL	844.37

M/A #

31931 RR

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK.

THE BREAKERS

3940

247

The Breakers
Palm Beach, Florida

BANQUET FUNCTION FOOD

11-80

2/19/81 Lunch 42 42

MAGNOLIA ROOM

3941

BUFFET

4/2? Dinner @ 24.50 1029.00

ACTUAL 38

PRATT & WHITNEY 15%
4%

FOOD	1029.00
BEVERAGE	—
SERVICE CHARGE	154.35
STATE TAX	47.33
TOTAL	1,230.68

M/A #

31931-RR

A SERVICE CHARGE OF 15% PLUS 4% TAX WILL BE ADDED TO THIS CHECK.

248

[illegible]
February 18-19, 1981
Presentation Center

Guests

Sweden

Air Material Dept. - AMD or preferably referred to as FMV

Sven Hoekborg	Chief of Aircraft Section
Johan Oester	JAS Project Group
Bo Gellerhed	JAS Project, Engine Dept.
Claes-Goran Bringdahl	Maintenance Dept.

FFV Maintenance Division

Lars Harry Larson	Supervisor, Engine O/H
Lars Svensson	Engine Maintenance

SAAB

Harald Schroeder	Liaison - JAS Project Manager
Gunnar Hellstroem	JAS Engine Responsibility
Stig Persson	A/C Product Support Manager

Volvo (VFA)

Bengt Eriksson	Executive VP
Nils Fax	Chief Engineer
Ragnar Blomqvist	Staff Engineer

Isreal - -

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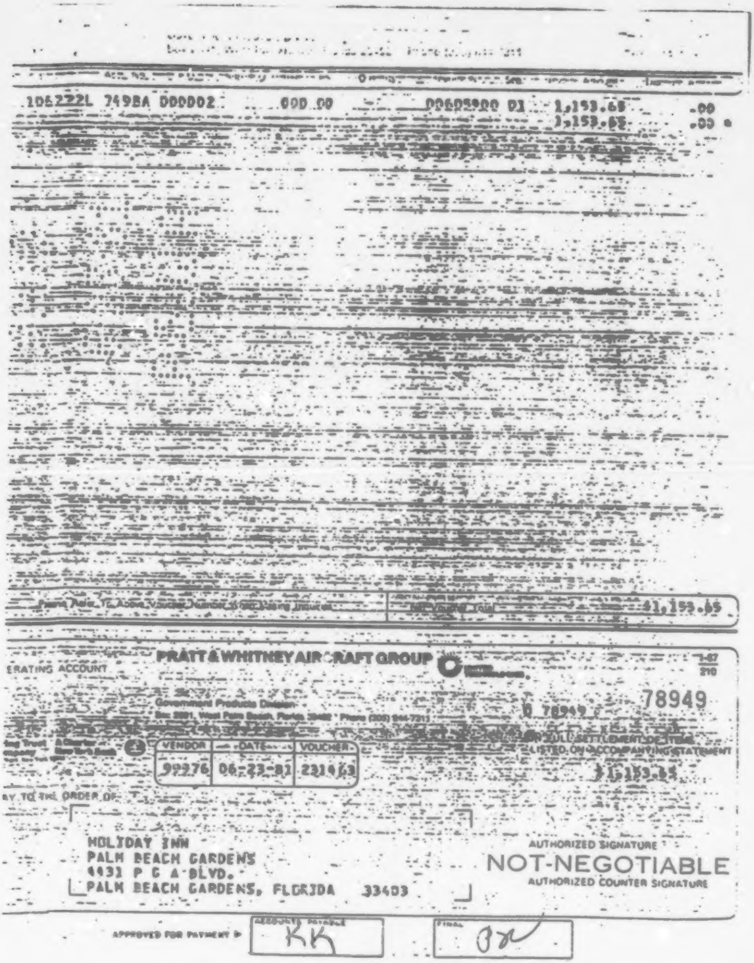


1052222L 7498A 000002	000.00	00605900 01	1,153.65	.00
			1,153.65	.00

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $1,153.65

PRATT & WHITNEY AIRCRAFT GROUP

[illegible]ERATING ACCOUNT

Government Products Division

Box 2691, West Palm Beach, Florida 33402 · Phone (305) 840-7311

1-87
210

78949

No 78949

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
99976	06-23-81	231463

$1,153.65

PAY TO THE ORDER OF

HOLIDAY INN
PALM BEACH GARDENS
4431 P G A BLVD.
PALM BEACH GARDENS, FLORIDA 33403

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶ ACCOUNTS PAYABLE KK FINAL

BEST COPY AVAILABLE

STATEMENT

605500

Holiday Inn
PALM BEACH GARDENS
IN THE GOLF CAPITAL OF THE WORLD
4421 PGA BOULEVARD AT I-95
PALM BEACH GARDENS, FLORIDA 33480

June 11, 1981
DATE

Pratt & Whitney Engineering Dept.
P O Box 2691 Mail Stop A-83
West Palm Beach, Fla. 33402
Att. Ben Koff

TOTAL AMOUNT DUE AND PAYABLE UPON RECEIPT OF THIS STATEMENT

6/5/81	Bartender Fee	30	00	
	10 Trays Hot Hors d'Oeuvre $ 35.00 ea.	350	00	
	4% Tax	14	00	
	15% Gratuity	52	50	
	8 qts. House Brands $36.00 ea.	288	88	
	4 cs Beer	120	00	
	3 lt. wine $8.75 ea.	26	25	Mc99976
	2 btl. Cutty $40.00	80	00	
	2 btl. Jack Daniels @ $40.00 ea.	80	00	
	4% Tax	23	77	
	15% Gratuity	89	13	
		,153	65	
			OK	

DEPT. APPROVAL	X
DEPT. NUMBER	700
ACCOUNT NUMBER	7498A

Engineering DEEC first flight Program

PRINTED IN U.S.A.

17A 7456A 0C0062 000 00 06611135 01 327.70 .00
327.70 .00 *

Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $327.70

PRATT & WHITNEY AIRCRAFT GROUP

S ACCOUNT

1-67
210

Government Products Division

0 78610

78610

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
99976	06-19-81	231145

$327.70

E ORDER OF

HOLIDAY INN
PALM BEACH GARDENS
4431 P G A BLVD.
PALM BEACH GARDENS, FLORIDA 33403

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

CUSTOMER RELATIONS
JUN 10 /10/
M.L.H. J.B.J.
E.B.W. R.L.W.

Holiday Inn
PALM BEACH GARDENS
IN THE GOLF CAPITAL OF THE WORLD
4431 PGA BOULEVARD AT I-95
PALM BEACH GARDENS, FLORIDA 33410

June 4, 1981
DATE

Pratt & Whitney
P O Box 2691 Mail Stop A-83
West Palm Beach, Fla. 33402
Attn: Ray Van Overschelde

TOTAL AMOUNT DUE AND PAYABLE UPON RECEIPT OF THIS STATEMENT

6/1/81	Tally Bar	275	35
	4% Tax	11	05
	15% Gratuity	41	30
		327	70

V/C 99976

DEPT. APPROVAL
DEPT. NUMBER X 816
ACCOUNT NUMBER 7498A
PW1120 personnel
final program discussion

BEST COPY AVAILABLE

6-19-81

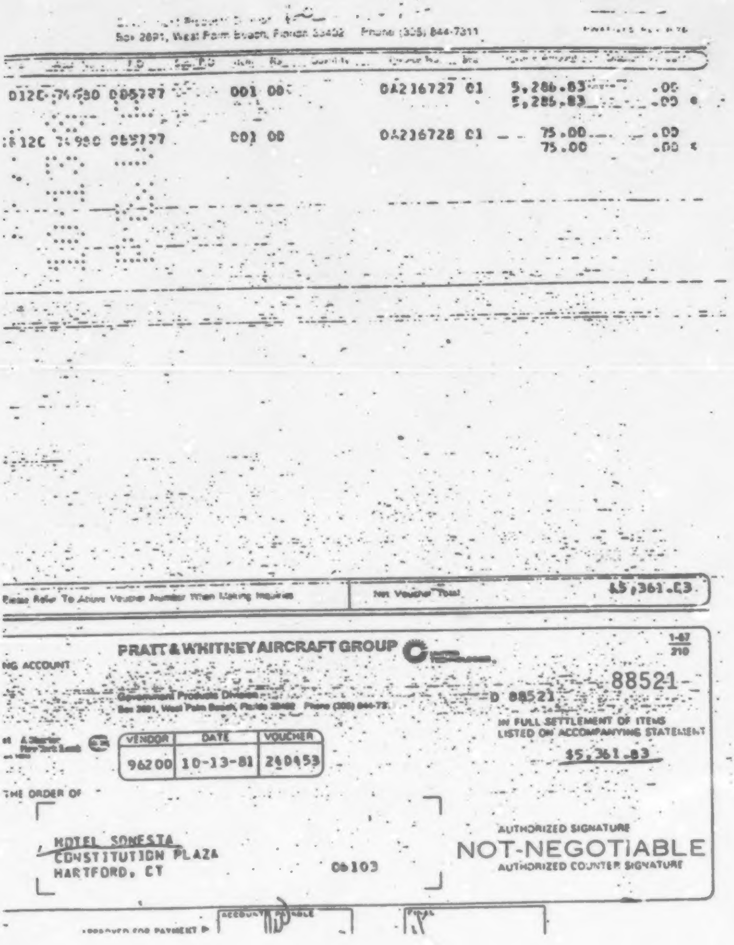
CAUTION: [illegible]

	Beverages	
1	J.B. (1.3)	54.60
2	Smirnoff (.4)	16.80
3	V.O. (.4)	16.80
4	Guipans (1)	42.00
5	Bourbon (.6)	21.60
6	Rum (.5)	18.00
7	Vodka (4)	14.40
8	Scotch (.1)	3.60
9	Whiskey (.6)	21.60
10	Gin (.2)	7.20
11	Beers 25 @ 1	25.00
12	Wine 3 Lites	26.25
13	2 Soda @ 3.75	7.50
		275.35

Thank You

SEE TOTAL OTHER SIDE

BEST COPY AVAILABLE



Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-7311

0120 74930	085727	001 00	0A216727 01	5,286.83 5,286.83	.00 .00	
0120 74980	085727	001 00	0A216728 01	75.00 75.00	.00 .00	

Please Refer To Above Voucher Number When Making Inquiries

Net Voucher Total $5,361.83

PRATT & WHITNEY AIRCRAFT GROUP

1-87
210

NG ACCOUNT

88521

Government Products Division
Box 2691, West Palm Beach, Florida 33402 Phone (305) 844-73

D 88521

IN FULL SETTLEMENT OF ITEMS LISTED ON ACCOMPANYING STATEMENT

VENDOR	DATE	VOUCHER
96200	10-13-81	240453

$5,361.83

THE ORDER OF

HOTEL SONESTA
CONSTITUTION PLAZA
HARTFORD, CT 06103

AUTHORIZED SIGNATURE

NOT-NEGOTIABLE

AUTHORIZED COUNTER SIGNATURE

APPROVED FOR PAYMENT ▶ ACCOUNTS PAYABLE

FINAL

BANQUET CHECK № 10111

OF FUNCTION P & WA

OF FUNCTION reception/dinner/dance COVERS 52 gtd

OOM Rendezvous/Plaza DATE 7-8-81 HOURS 6 pm

BILL TO Pratt & Whitney Aircraft

ADDRESS P O Box 2691 Mail Stop A15 West Palm Beach, FL 33402

CHECK NO. ________

ANTITY	DETAILS	UNIT PRICE	TOTAL
	Bar Sales including cordials		1164.95
100	Assorted Canapes		75.00 ✓
300	Shrimp		300.00 ✓
1	Cheddar Wheel		57.50
200	Swedish Meatballs	49.50	99.00 ✓
200	Sweet & Sour Chicken	49.50	99.00 ✓
1	Raw Vegetable Platter		37.50 ✓
100	Scallops		65.00 ✓
	Wine Sales		216.00 ✓
37	Lobster	26.00	962.00 ✓
45	Filet	22.50	1012.50 ✓
30	Coffee, Tea	.85	25.50 ✓
	15% Gratuity		617.09
	7½% Tax		308.54
	Flowers		247.25

Mr. Dingell. I believe you have seen copies of these documents.

Mr. Spanton. Yes, sir.

Mr. Dingell. And you are familiar with them?

Mr. Spanton. Yes.

Mr. Dingell. As a matter of fact, I believe you gave copies of these to FBI Agent Cavanaugh; is that correct?

Mr. Spanton. I believe so.

Mr. Dingell. Can you tell us when you did that?

Mr. Spanton. It would have taken place in late 1982 or early 1983.

Mr. Dingell. Was that at the time when there was a grand jury investigation going on?

Mr. Spanton. Yes.

Mr. Dingell. It was?

Now, the gentleman from New York.

Mr. Eckert. Mr. Chairman, I was going to get to a question earlier when I was on the gentleman from Oregon's time, and I want to pursue that a little bit more.

In the quote that I was giving from the Reader's Digest article I asked you about the comments about premature release of information and unauthorized. It was the "unauthorized" I wanted to get to.

Running through that profile on you in the Digest is an observation that we tend to punish those who expose waste and reward those who cover it up. There is a quote in here from the merit board, very favorable, about you. And what I wanted to get to was that you were very specific earlier and very helpful on auditing suggestions, and I thought it might be helpful to us if you could perhaps give us the benefit from your experience of some suggestions on how to treat the whistleblower issue, and if you could tell us what sort of changes you think might be in order to encourage rather than discourage calling attention to waste and abuse.

Mr. Spanton. Yes. Earlier, I mentioned the statutes referred to by the contractor in stamping all their documents USC as proprietary data. I think that matter ought to be cleared up because that in itself is inhibiting individuals from coming forward and releasing information.

Second, based upon my own experiences, as I spoke out, I still haven't become enmeshed in legal entanglements—I found that my agency had unlimited resources in terms of attorneys coming to their defense and they were the attackers. And I had nobody to turn to. In fact, during the period of time when I was giving depositions—and this is indelibly in my memory—I recall that I was required to give the depositions without an attorney while the agency response to my request for some legal guidance to assist me in responding to their what I call interrogations was to go out and hire my own attorney; all the other attorneys were committed to DCAA management.

So even the Office of Special Counsel that was present during the period of my questioning, which lasted approximately 4 days in the conference room of the DCAA Director, which was supposed, I guess, to be inhibiting in itself, I was supposed to attend without an attorney, and the Office of Special Counsel said that they were only representing the Government and they couldn't help me.

So whistleblowers need some sort of assurance that they will get legal protection without having to go out and hire their own lawyer when they're trying to do the Government a good turn. And instead of burying this all within the administrative system, to get it out in the open in a court of law, because based upon my own experiences, William O'Conner, who heads up the Office of Special Counsel—and this is a presidential appointee—told me personally that if he couldn't win my case, then he couldn't win any case. And his advice to whistleblowers was if they want to survive, to keep their heads down or their heads will be blown off. In other words, be quiet.

So here is the man assigned to protect whistleblowers telling whistleblowers under the present law and the present system, don't do it.

Mr. ECKERT. What specific suggestions for improvements might you make?

Mr. SPANTON. Well, I think the Office of Special Counsel ought to be moved out, it ought to be beefed up and they should have the opportunity to take these matters into the judicial system, into the Federal courts.

My case was heard before an administrative judge who just happened to be a retired military man. Whether that influenced him or not I can't say, although I did feel that I would have rather have had it otherwise. And provide protection, real protection, for what I have seen so far is there has been a great deal of talk from the administration on down that whistleblowers should come forth and help the Government in its time of crisis. But then, we will take care of you.

So that message is out. In fact, many potential whistleblowers contact me and they pass information on to me, but they are simply scared to death.

I have to add this—that even individuals within my own office felt they were in jeopardy during the period of time that I was involved. And it is a trying experience for some of these people, and yet, very recently within the last week, I had a young individual in the Navy have his mother contact me, and I guess he is in his third or fourth year in the Navy. He had his mother contact me and she came to my house and brought me a couple of small computer parts which she said were defective. They were replaced and he saw that he could buy them in a Radio Shack catalog for about $40 and the Government was paying something like $12,000 to $14,000, and it bothered him. And we're talking about a 22- or 23-year-old individual. It bothered him, and he didn't give a damn if it came out or not, but he wanted to do something about it.

But he heard about my case and his mother took the trouble to deliver the information to me, and he said he is going to pass additional information on to me, and his other shipmates are similarly concerned.

So there are people who want to do what's right, but they have to somehow be encouraged to come forward, and I know that my case got a good deal of publicity and a lot of coverage, and I know that William O'Conner handled my case personally so he must have felt very strongly himself. And yet, every possible roadblock was put in my way, and I found individuals whom I knew for 10 or

15 years, and I learned on the job—and they're just acquaintances, not really friends but people you know—and they would come up with the minutest details as to why they could put me down in testimony. The most unimportant events would suddenly be used by these individuals in testimony in order to discredit me.

And I found that I was an outcast. I recall going to a conference of the DCAA in Memphis, and while all the tables in the meeting room were jammed, I had no problem getting a seat; in fact, I had no problem getting a whole table.

Mr. ECKERT. I understand that. I appreciate it very much, and I did make the point that one theme of the Digest article is that cases like yours and others show that we punish those who expose waste and reward those who cover it up.

But what I was searching for was some more specific suggestions on how we might tighten controls to insure that it is not the case; that you don't have to have a well-publicized case as your only hope of protection.

Mr. WYDEN. If the gentleman would yield.

Mr. ECKERT. No; I want to hear the answer.

Mr. SPANTON. The only way you can do this is with some very specific laws which will ascribe severe penalties to those management people that would take actions to retaliate against these individuals that are trying to do their Government a service. And there ought to be criminal statutes introduced; not just a slap on the wrist.

Most of these individuals I'm talking about, it's kind of a ping-pong ball; every other year they're going to get their $10,000 to $20,000 bonuses. I'm talking about the management people. And whether they go after some whistleblower or not doesn't have any impact on——

Mr. ECKERT. I appreciate it, and maybe these are matters that we might want to take a little bit more time for reflection to get some specifics. But I would ask the chairman if the gentleman could, at some point, submit them. I think they would be useful to this committee and to the Congress.

Mr. DINGELL. I think it would be very useful to us, and I concur with the gentleman's judgment. The time of the gentleman has expired.

The Chair will recognize the gentleman from Minnesota.

Mr. SIKORSKI. I thank the Chairman.

I think you testified, Mr. Spanton, that some of these executive salaries were running 40 to 45 percent above what private industry was paying for a like situation. In 1981, as I understand it, there were $266,293 in leasing costs for executives' automobiles; is that correct?

Mr. SPANTON. That sounds correct.

Mr. SIKORSKI. And you disallowed that?

Mr. SPANTON. Yes.

Mr. SIKORSKI. You didn't approve it.

As I understand this deal, the executives who got these rental cars were allowed to buy back the cars at discounts, averaging 36 percent; is that correct?

Mr. SPANTON. 36 to 40 percent less than the wholesale book value.

Mr. **Sikorski**. So in one case, we found you had a Mercedes with an original value of $24,836 that was bought by the executive 2½ years later for $6,600. Another case, a $15,650 Cadillac after 2 years was bought by the executive for $6,904. Are those the kinds of instances that you saw?

Mr. **Spanton**. Yes.

Mr. **Sikorski**. We have a lot of foreign cars. You had Mercedes, and XR-7's and BMW's and Datsun 300 ZX's and Porsches and a host of other foreign cars; isn't that correct?

Mr. **Spanton**. Yes.

Mr. **Sikorski**. And is this under the FBI limbo situation, too?

Mr. **Spanton**. Yes, sir.

Mr. **Sikorski**. Thank you. I thank the Chairman.

Mr. **Dingell**. The Chair thanks the gentleman.

Mr. Spanton, the committee thanks you for your very helpful and patient testimony. You have been here a long time. We are most appreciative of your assistance to us, and we want you to know that we are very grateful to you for what you have done in terms of assisting the committee in its labors and considerations in this matter.

Our next witness will be Mr. Dennis Modesitt. Mr. Modesitt, if you will come forward we will hear your testimony, and we apologize for having kept you so long.

Mr. Modesitt, do you have any objection to appearing under oath?

Mr. **Modesitt**. No.

Mr. **Dingell**. Mr. Modesitt, do you desire to be advised by counsel?

Mr. **Modesitt**. No.

Mr. **Dingell**. Mr. Modesitt, you will observe that copies of the rules of the committee and subcommittee are there to assist you in your consideration of your rights and the limitations on the power of the committee.

If you will please raise your right hand.

[Witness sworn.]

Mr. **Dingell**. You may consider yourself to be under oath. Do you have a prepared statement?

TESTIMONY OF DENNIS MODESITT, FORMER DEPARTMENT OF DEFENSE ADMINISTRATIVE CONTRACTING OFFICER FOR GENERAL DYNAMICS

Mr. **Modesitt**. No, I do not.

Mr. **Dingell**. Mr. Modesitt, the Chair observes that calendar year 1977 was the last year that the Navy was able to completely settle overhead with General Dynamics. The 1977 overhead was settled with General Dynamics in April 1981, and General Dynamics received $22 million for their 1977 overhead expenses.

In that year, DCAA questioned about $4.7 million in overhead costs, but the Navy gave General Dynamics $3.2 million in disputed costs. Are those facts correct?

Mr. **Modesitt**. Sir, I can't answer. I haven't seen those figures actually for 4 years—the files.

Mr. DINGELL. Most notably, the Navy gave General Dynamics $1.4 million of the $1.9 million of disputed costs claimed for corporate aircraft, even though General Dynamics destroyed all passenger lists.

Also, the Navy gave General Dynamics $340,000 of some $500,000 in disputed travel costs which were noted to be primarily entertainment costs.

The 1976 calendar year overhead settlement was not much different, as the Navy gave General Dynamics $1.7 million of $3 million in similarly disputed costs.

The subcommittee's staff recently interviewed you. You were at that time the contracting officer that settled the overhead in the year 1977. In your discussions, did you advise the staff that you had been unwillingly thrown by the Navy into the position of negotiating overhead?

Mr. MODESITT. No, sir. Not unwillingly.

Mr. DINGELL. Did you advise the staff that you were too inexperienced to handle that particular task?

Mr. MODESITT. No, sir, that was not a problem, either.

Mr. DINGELL. Did you advise the staff that you were overworked?

Mr. MODESITT. I think, based on earlier discussions, what we were talking about was the responsibility for the corporate administrative contracting officer, which I was required to do, along with other staff work. In other words, the two jobs were merged.

As far as the negotiation of overhead, it was just one of the functions of the CACO operation.

Mr. DINGELL. Did you complain to your superiors about the burden that this would impose on you?

Mr. MODESITT. I discussed it with them and the coordinated negotiation staff at the time that I was actually selected. It was a choice of one of two people; that in my view, the job could not be done on a part-time basis; and further, that the location in Washington I didn't think was a good idea because I believe the CACO should be located at the corporate office in St. Louis.

Mr. DINGELL. You were located where?

Mr. MODESITT. In Washington.

Mr. DINGELL. And the discussions took place where?

Mr. MODESITT. In Washington. Or Arlington.

Mr. DINGELL. You were told by your superiors to do the best job you could, isn't that what occurred?

Mr. MODESITT. Yes; actually, the corporate administrative contracting officer had been located in our branch. It was a full-time operation. At the time he retired, just before he retired, the billet or the position or the body, as you may say, was removed and taken to somewhere else in Navy Materiel Command, and therefore the function was left in the office with the reduced staffing.

Mr. DINGELL. So you were assigned the responsibility, then, as corporate administrative contracting officer for General Dynamics in addition to your other responsibilities?

Mr. MODESITT. Yes, sir, that's generally correct.

Mr. DINGELL. When did you enter on this duty and when did the duty end?

Mr. MODESITT. It was mid-March 1980, and it ended on May 4, 1981. I believe the date was March 20, 1980, and May 4, 1981.

Mr. Dingell. Please explain the circumstances under which you received your appointment as General Dynamics CACO. Had it been planned for you to take over this position?

Mr. Modesitt. I don't really know the answer to that. It sort of came to me, you might say.

Mr. Dingell. Who was it that assigned you that responsibility?

Mr. Modesitt. Well, my immediate supervisor assigned the responsibility. The certificate of appointment was issued by the Assistant Deputy Chief of Naval Material for Contracts and Business Management.

Mr. Dingell. Had you ever previously served in the capacity of a corporate administrative contracting officer?

Mr. Modesitt. No, I had not.

Mr. Dingell. How did you feel about taking over this position?

Mr. Modesitt. Well, I wasn't too happy about it in the circumstances, based on the limited amount of time in which I would have to perform the duties.

Mr. Dingell. Why do you say the limited amount of time in which you would have to perform the duties? Were you preparing to retire?

Mr. Modesitt. That was one of the reasons. The other was that, as it turned out, I found approximately an average of 1 day a week that I was able to devote to this particular job.

Mr. Dingell. You have indicated that prior to your embarking on this occupation, it was a full-time job?

Mr. Modesitt. It was a full-time job; however, certain functions were taken off which would approximate, I guess, to one day a week.

Mr. Dingell. What steps did you take to learn your new duties in this capacity?

Mr. Modesitt. I referred to the Defense acquisition regulations.

Mr. Dingell. Did you ever complain to your superior about your lack of experience and the problems of time in handling and learning to handle this position?

Mr. Modesitt. Not after I was given the warrant as contracting officer.

Mr. Dingell. Not after what?

Mr. Modesitt. Not after I was given the warrant as contracting officer.

Mr. Dingell. Did you complain prior to that time?

Mr. Modesitt. It was discussed prior to that time.

Mr. Dingell. And what was the response of your superiors?

Mr. Modesitt. My superior was sympathetic, and he understood. As a matter of fact, I might extend an opinion that he certainly was not in favor of losing the billet at the time it happened.

Mr. Dingell. Were you ever at corporate headquarters of General Dynamics in St. Louis?

Mr. Modesitt. No.

Mr. Dingell. Mr. Modesitt, the subcommittee staff has reviewed the available files regarding your negotiation in April 1981 of General Dynamics corporate overhead for 1977. The files show—and without objection, attachment A will be inserted in the record—that although DCAA questioned $4.7 million in overhead costs, you allowed General Dynamics $3.2 million of these costs anyway.

[The information follows:]

ATTACHMENT A

DEPARTMENT OF THE NAVY
HEADQUARTERS NAVAL MATERIAL COMMAND
WASHINGTON, D.C. 20360

IN REPLY REFER TO
NAVMAT 08CD/
16 April 198

MEMORANDUM FOR THE CORPORATE AUDIT COORDINATOR - GENERAL DYNAMICS

Subj: Results of Negotiations, General Dynamics Corporate Office Expenses for Calendar Year 1977

Enclosed is a copy of the agreement reached on the subject negotiation accompanied as a schedule detailing costs disallowed.

Dennis E. Modesitt
Dennis E. Modesitt
Corporate Administrative
Contracting Officer

ATTACHMENT

[illegible]

GENERAL DYNAMICS

RESULTS OF NEGOTIATIONS OF CORPORATE OFFICE EXPENSES (APRIL 6, 1981)
1977

COST QUESTIONED BY DCAA	DCAA $ QUESTIONED	SUSTAINED IN NEGOTIATION BY ACO
SALARIES AND EMPLOYEES BENEFITS	445,449	62,000 1/
TRAVEL	494,868	160,000
PROFESSIONAL SERVICES LEGAL	349,780	49,000
CORPORATE MEMBERSHIPS	20,625	18,000
INDIVIDUAL DUES	98,353	88,000
COMMUNICATION EXPENSES	88,390	25,000
EXHIBITS	619,805	495,000
PROMOTIONAL MATERIAL	13,412	10,000
DIRECTOR'S EXPENSE + FEE	142,206	18,000
AIRCRAFT COSTS	1,937,792	531,000
RELOCATION EXPENSES	56,012	19,000
PROFESSIONAL SERVICES OTHER	215,807	25,000
MISCELLANEOUS - OTHER	255,629	-0-
TOTAL	4,689,598 ↔	1,500,000

NOTES: 1/ McDONALDS SALARY, $146,574, IS DIRECT CHARGED TO ELECTRIC BOAT DIVISION. FRANCHISE TAX AND GROUP HEALTH COST SET ASIDE IN PREVIOUS NEGOTIATONS $79,633, ARE TO BE REDUCED FROM THE AMOUNT SUSTAINED ABOVE.

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Mr. DINGELL. Most notably, DCAA questioned costs of $1.9 million for corporate aircraft, and you overruled DCAA and allowed General Dynamics $1.4 million of the costs, or over 70 cents on the dollar.

What do you remember about this matter?

Mr. MODESITT. Is the question in total or regarding the aircraft costs?

Mr. DINGELL. Regarding the total and regarding the aircraft costs.

Mr. MODESITT. If I may take a moment, I would like to explain the procedures that we used in arriving at the amounts of allowable costs. First of all, Mr. Spanton spoke to you as the contract auditor and explained that they did prepare and provide for contracting officers advisory audit reports. This was true in the case in hand.

When the reports are received, they are reviewed and a rough decision is taken at that time before negotiation. Also, the contractor is asked to prepare a report or a rebuttal to the audit report so he would be in a position to negotiate at the time when this comes to negotiation.

After those reports are received, I take the reports and sit down and analyze all the line items in it and come up with a rough negotiation position, then meet with contract auditors for a prenegotiation briefing on the reports and their input, schedule negotiation and ask the contractor to advance his rebuttal and ask the auditor for his input.

At that time the formal negotiation process starts.

With respect to the dollars, I can't answer how they were arrived at. I can tell you generally that they were arrived at in this manner. When an item of cost contained an allowable item, it was judged in light of reasonableness. If the item of cost was commingled, the first thing that had to be done was to remove what we believed to be the unallowable cost and then determine the reasonableness of the balance of the costs in the account.

Those are the general parameters in which the decision was made.

After going through the accounts, the total figure is a result of that type of operation. Now, at this time I cannot tell you how the percentages and so forth, or how we arrived at the specific things.

Mr. DINGELL. Mr. Modesitt, were you ever suspicious as to why General Dynamics destroyed the passenger lists for corporate aircraft rather than providing them to the Government?

Mr. MODESITT. I am not sure at the time. I do recall an incident where there was no support documents for some of the aircraft costs, and I don't recall—I somehow don't recall that that was a matter that was destroyed at that time. It may have been, but I don't recall it that way. It was not available or it couldn't be found, documents to support the costs.

Mr. DINGELL. A private auditor would not have recommended approval of those, nor would a private auditor have approved the settlement of costs which did not show the purposes of the expenditure or the persons for whom the expenditure was made; isn't that correct?

Mr. MODESITT. I think that's correct.

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Mr. DINGELL. So it was rather unusual that you received lists of corporate flights which did not identify the passenger lists; was it not?

Mr. MODESITT. No. I sort of——

Mr. DINGELL. Was this a regular practice for contracting in the Defense Department, to permit aircraft flight vouchers to be unaccompanied by proper supporting data, including the names of the persons for whom the flight was made and the purposes for which the flight was made?

Mr. MODESITT. I can't speak to that. I can say that in my experience in negotiating, the problem of aircraft costs with other companies has not been a substantial issue, so therefore, I cannot say. But with respect to that, when there is no documentation, I'm sure it does—the negotiated amount reflects a reduction of costs, and that certainly was taken into account.

Mr. DINGELL. I observed that a DCAA memo of April 9, 1981 on your 1977 negotiations stated that General Dynamics threatened "to appeal to the Armed Services Board of Contract Appeals" the corporate aircraft issue if the Navy didn't settle favorably. [See p. 264.]

Did this threat affect your position in any way?

Mr. MODESITT. No, sir. I have heard that type of threat before.

Mr. DINGELL. Why did they threaten to go to the Armed Services Board of Contract Appeals?

Mr. MODESITT. I don't really know. I don't recall why.

Mr. DINGELL. The Chair is going to turn the Chair over to the gentleman from Oregon and to recognize him. The Chair has got to leave the room for a minute.

Mr. WYDEN [presiding]. Thank you.

Mr. Modesitt, give us your thoughts in general on the ASBCA. Particularly, we would like to know why the Government seems to do so poorly when taking on the contractors at the ASBCA. Do you think the Government negotiators and trial lawyers are intimated because of the Government's poor track record and therefore doesn't even bother to take the legitimate cases to the Board?

Mr. MODESITT. I don't think so. I think the problem is probably deeper than that, in that many of the cost principles we have to negotiate with are such that there is a very broad interpretation of what they mean. And many cases are forced in the Board of Contract Appeals. If the cost principles were more specific, I don't think it would be necessary to take that many cases to the Board. As I recall, our track record in the Government was rather bad with respect to ASBCA cases.

Mr. WYDEN. Do you think that the Government trial lawyers are a match for the lawyers of the contractors?

Mr. MODESITT. Well, I would say this: that the contractor is certainly in a position to hire specialists, outstanding specialists, consultants, attorneys with proven track records in this type of thing, and I certainly think he is much better equipped when he goes to the Board with a case.

Mr. WYDEN. Do you think one of the reasons the contractors are typically in the position to hire the top legal talent and all this other that you discuss is because they can bill these costs to the Government?

Mr. MODESITT. I have forgotten what the regulations are. I believe if they win the case, they can; if they don't win the case, they don't. As I say, it has been a while.

Mr. WYDEN. Mr. Modesitt, the subcommittee staff has obtained some of the flight logs for 1977, which show numerous personal flights billed to the Government, such as flights to and from Miami for Henry Crown, and flights to and from Brunswick, GA, to shuttle Mr. Lewis to his former residence.

Did you ever consider this personal use of corporate aircraft in your settlement with General Dynamics?

Mr. MODESITT. As I indicated earlier—I don't recall specifically the issue you are referring to. As I indicated earlier, the criteria for coming down to some decision is to eliminate unallowable costs where costs are commingled. In other words, if you have personal flights or flights that are unwarranted in an account where there were legitimate flights, they should be removed. So with respect to that, I would have to answer it on that basis, that it would be, in my view, unallowable costs to the contracts.

Mr. WYDEN. How could you settle the costs without knowing who the passengers were?

Mr. MODESITT. I don't know how many there were. I'm sure there were many, many, many. I think the nature of the use of the plane, the criteria would be based on the nature of the use of the plane and whether or not trips were warranted, and the reasonableness of the cost.

Mr. WYDEN. Well, we are quite sure that there were many, many. That has never been in question. But again, how can we go out and have a settlement that is in the interest of the taxpayers unless we know who the passengers are?

Mr. MODESITT. I don't know how we know who the passengers are. We keep referring back to that. As I indicated to you, it is alleged that these were destroyed. There were some records destroyed? Is that correct?

Mr. WYDEN. They were destroyed. Nobody disputes that.

Do you want to take another crack at the question?

Mr. MODESITT. No. I don't know. I don't recall it as such. I do recall that there was a difficulty of locating some records to support it, and the destroyed business doesn't ring a bell. If it happened, I certainly do not recall it.

Mr. WYDEN. But how do we know that it had anything to do with Government business unless you know who the passengers are?

Mr. MODESITT. Well, it's a good question. I'm not sure that I can give you an answer. As I said, in arriving at this sort of thing, you have to use the same type of criteria. I think the question comes down that wherever possible, eliminate those costs which are not applicable and consider the balance in the light of reasonableness.

Mr. WYDEN. I think that is a great principle. I just don't see how it was applied in this case.

Mr. Modesitt, were you aware of an October 27, 1980 memo from the DCAA which states that contracting officers are advised to disallow any unresolved costs due to manifest log documentation deficiencies?

Mr. MODESITT. I'm sorry, I am not—Am I aware of a memo—Would you repeat it?

Mr. WYDEN. Were you aware of an October 27, 1980 memo from the DCAA which states that contracting officers are advised to disallow any unresolved costs due to manifest log documentation deficiencies? It is there in your materials, attachment D. Excuse me.

Mr. MODESITT. Am I aware of it right at the moment? No, sir.

[Testimony resumes on p. 278.]

[The documents referred to follow:]

[illegible] 4-2

DEFENSE CONTRACT AUDIT AGENCY
CHICAGO REGION
ST. LOUIS BRANCH OFFICE
210 NORTH TUCKER BLVD., ROOM 1148
ST. LOUIS, MISSOURI 63101

IN REPLY REFER TO

3201/0A490.004
CAC 81-105

9 April 1981

MEMORANDUM FOR THE RECORD

SUBJECT: Trip Report on Auditor Attendance at Negotiation Conference of General Dynamics Corporation Corporate Office Expense, CFY 1977

A negotiation conference was held on 13, 14, and 15 January 1981 between the Corporate Administrative Contracting Officer and General Dynamics (GD) Corporation Representatives at the General Dynamics Washington Office facilities.

Attendees at the conference were:

Dennis Modesitt, CACO, NAVMAT
Michael Kuc, HQ AFSC/PMMO
Joe Bennett, PLA, DCAA, NAVMAT
Norton Olser, DCAA, GD Corp., Office
Kay Papin, DCAA, GD Corp., Office
Ray Crain, GD Corp., Office
George Owens, GD Corp., Office
F. J. Tylman, GD Convair

The Government representatives met on the morning of the 13th. Since Mr. Modesitt was appointed CACO, he has not previously negotiated GD Corporate Office expense and was not familiar with GD expenses or practices. The morning and part of the afternoon was spent with DCAA going through each item of questioned cost and explaining the DCAA position and the contractor's rebuttal to the CACO. Mr. Modesitt was generally receptive to the DCAA position on the questioned cost. However, he said that there were some items that he felt could not be sustained, and some of the items were in a gray area and would have to be negotiated.

After all of the questioned items were discussed with the CACO, the contractor joined the conference. At this time, the CACO went through each of the questioned items with the contractor to get the contractor's position; amounts were not discussed. The contractor and the CACO agreed that significant items of expense would be considered individually by pool; all others would be negotiated in total by type of expense and allocated to pools. Direct charges would be pulled out of the pool.

The first item discussed was the special allocation of 22% of the residual pool to Asbestos Corporation and GD Manufacturing Ltd. The CACO asked the contractor if they had any study or documentation to support less than the full allocation. Mr. Crain said that the 22% was negotiated with Mr. Webb the CACO in 1974. He said GD had submitted substantiation for 11%, but had settled for 22% with Mr. Webb. The contractor said the agreement was to remain in effect until conditions changed enough to warrant a reevaluation of the special allocation.

ATTACHMENT B

3201/OA490.004

The CACO said it was obvious from the audit report that conditions must have changed. The contractor finally agreed to reevaluate the basis for the special allocation and submit substantiation for audit before the next OH proposal. However, the issue may become insignificant if the Canadian Government takes over Asbestos Corporation and the issue is limited to GD Manufacturing Co. The CACO conceded this questioned cost in his first offer the next day.

The remainder of the first day (13 January) was spent going through each category of questioned cost and the contractor rebutting each item. In some cases the contractor produced additional documentation. Based on new information received it became apparent that DCAA would have to concede some minor amounts of questioned cost. However, generally the DCAA position would not change significantly from the audit report. The discussion continued for the remainder of the day, and it was agreed to continue through the items of questioned cost the next morning.

The meeting was resumed on the morning of 14 January with DCAA assisting to CACO in preparation of a Government offer. It became apparent that the CACO was following the prior years negotiations in preparing his offer. The auditor emphasized to the CACO that most of the questioned cost was considered unallowable and should not be subject to negotiations.

Later the contractor returned and discussion of the questioned items was resumed. A protracted discussion of aircraft expense followed; and it was reemphasized by DCAA that the contractor had not adequately demonstrated that the use of the aircraft is necessary for the conduct of its business, and that the increase in cost in comparison with alternate means of transportation is commensurate with the advantage gained. The contractor representative stated that GD did not intend to concede anything on the aircraft expense. He said that they were presently awaiting an ACO decision on a similar matter at Convair, and if necessary GD would appeal to the ASBCA.

After discussion of the questioned items, the CACO submitted an offer $3 million questioned. The contractor did not counter but left the room to evaluate the offer.

While the contractor was not in attendance it was reemphasized to the CACO by DCAA that in almost all cases the questioned expenses were clearly unallowable and should not be subject to negotiation.

The contractor representatives returned later in the afternoon, and said that, although that was the worst offer they had ever received, they would submit their counter offer of $600,000.

The CACO told the contractor that its offer was unacceptable and wasn't even close to a settlement. After some discussion on the elements questioned the meeting was adjourned.

ATTACHMENT B

GENERAL DYNAMICS CORPORATION
Pierre Laclede Center
St. Louis, Missouri 63105

12 April 1985

[illegible]

Mr. Art Brouk
Subcommittee on Oversight and Investigations
House Committee on Energy and Commerce

HAND DELIVERED

Subject: Corporate Aircraft Expenses - 1976 and 1977

In response to your memo dated 6 March 1985, there is attached trip logs for 1976 and 1977 on Corporate aircraft. As in the later years, passenger lists, except for the name of the principal passenger as shown on the trip logs, were not maintained. There was no requirement in applicable Government regulations or our contracts for the maintenance of such lists.

Also attached is a scheduling calendar maintained by the Flight Department on the Gulfstream and Sabreliner aircraft for 1977. The Flight Department advises that these, along with trip logs for 1977, are the only flight and passenger records that they have in their files. The 1976 trip logs, in fact, are copies of the trip logs which we retained in my office for preparation of our overhead proposal. At no time did this office ever have the flight logs. The Flight Department advises that they have no 1976 data remaining in their files. I am told that some years ago they ran out of storage space in the Flight Office, and probably there was no perceived need to retain such records for a long period of time.

At the time we filed our proposal for negotiation of Corporate Office overhead for the years 1976 and 1977, we excluded all flights which were either unallowable or where no specific business purpose could be attributed. The amount excluded for such "unallowable" flights, together with the additional amounts excluded in negotiation of the final settlement of the Corporate Office overhead for these years, significantly exceeds the cost of all flights that could be perceived as unallowable or as having no specific business purpose as we have been applying those terms in today's environment.

GENERAL DYNAMICS CORPORATION

W.E. Chain
Corporate Director
Government Contracts Settlements

Attachments

ATTACHMENT C

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ATTEST: J. J. [illegible]
Manager/Chief Pilot

GENERAL DYNAMICS

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

Number of passengers

MONTH April 1977

AIRCRAFT NUMBER [illegible]

Flt. No.	Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
	1	0-87	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	J. [illegible]	3	[illegible]	[illegible]	[illegible]	Return to St. Louis
	1	0-88	[illegible]	[illegible]	[illegible]	[illegible]	381	[illegible]	D. [illegible]	2	[illegible]	762	[illegible]	Local Union, Tour
	6	0-89	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	G. Fiske	4	11	[illegible]	10,083	D-C Facility Visit
	8	0-90	[illegible]	[illegible]	[illegible]	[illegible]	381	[illegible]	G. Fiske	4	15	[illegible]	11,303	D-C Facility Visit
	8	0-91	[illegible]	[illegible]	1:00	[illegible]	641	[illegible]	G. Fiske	4	19	[illegible]	13,160	Return to St. Louis
	7	0-92	[illegible]	DCA	1:30	8:20	756	3866	D. S. Lewis	1	20	756	13,903	LRB Meeting
	7	0-93	DCA	[illegible]	2:40	10:50	756	4600	D. S. Lewis	3	23	2268	16,293	Return to St. Louis
	11	0-94	[illegible]	[illegible]	[illegible]	[illegible]	1094	5694	[illegible] McDonald	2	25	2188	18,481	Return to [illegible]
	13	0-95	[illegible]	DCA	2:00	13:48	1260	6953	-	-	25	-	18,481	Position airplane
	13	0-96	DCA	STL	2:30	17:43	1181	8064	W. Crowe	1	26	1181	19,381	Board Meeting - St. Lo
	13	0-97	STL	DCA	2:05	20:18	1089	9143	W. Crowe	3	29	2098	22,080	Return pax to Miami
	14	0-98	DCA	[illegible]	2:35	22:43	1080	10,240	-	-	29	-	22,080	Return to St. Louis
	15	0-99	[illegible]	[illegible]	0:45	23:30	380	10,360	G. Fiske	2	31	2333	25,413	Meeting W/[illegible]
	15	0-100	[illegible]	[illegible]	0:50	24:20	381	10,701	-	-	31	-	25,413	Return to St. Louis
	18	0-101	[illegible]	DCA	1:50	26:10	733	11,346	D. S. Lewis	1	32	733	26,146	Luncheon & Speech
	18	0-102	DCA	[illegible]	0:55	27:05	317	11,663	-	-	32	-	26,146	Position airplane
	19	0-103	[illegible]	[illegible]	2:35	29:40	1067	12,730	G. MacDonald	4	36	4268	30,414	Return to St. L[illegible]

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ATTEST: J. J. [illegible]
Manager/Chief Pilot

GENERAL DYNAMICS

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

MONTH April 1977

AIRCRAFT NUMBER [illegible]

Flt. No.	Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
	21	0-105	[illegible]	[illegible]	2:30	33+00	1060	15,182	C. MacDonald	6	40	6373	34,409	Return from Planning
	21	0-106	[illegible]	[illegible]	0:20	33+20	67	15,249	T. Valiotis	1	41	67	34,476	Return from Planning
	21	0-107	[illegible]	[illegible]	2:23	35+33	1001	15,[illegible]	-	-	41	-	34,476	Return to St. Louis
	26	0-108	[illegible]	[illegible]	0:11	[illegible]	[illegible]	[illegible]	-	-	41	-	34,476	Position airplane
	26	0-109	[illegible]	[illegible]	1:00	37+40	417	16,013	L. Crown	1	42	417	35,893	[illegible] Board Meeting
	27	0-110	[illegible]	TUL	0:35	38+15	235	16,248	L. Crown	1	43	235	[illegible]	[illegible] Board Meeting
	27	0-111	TUL	[illegible]	[illegible]	39+10	[illegible]	[illegible]	-	-	43	-	[illegible]	Return to St. Louis
	28	0-112	[illegible]	[illegible]	1:55	41+05	945	17,332	G. Fiske	3	47	2835	[illegible]	Pax pick up
	28	0-113	[illegible]	[illegible]	0:25	41+30	86	17,418	G. Fiske	4	51	344	[illegible]	Pax pick up
	28	0-114	[illegible]	YUL	0:50	42+20	[illegible]	17,[illegible]	G. Fiske	5	56	1660	40,227	Annual Stockholders M
	28	0-115	YUL	STL	2:00	44+20	[illegible]	18,[illegible]	-	-	56	-	40,227	Customs Clearance
	28	0-116	STL	[illegible]	0:10	44+30	30	18,[illegible]	-	-	56	-	40,227	Return to St. Louis

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GENERAL DYNAMICS

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

ATTEST: J. J. [illegible]
Manager/Chief Pilot

MONTH Jan 1977

AIRCRAFT NUMBER [illegible]

Number of passengers

Date	Trip No.	From	To	Time	Total Time	Dist. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
1	0-160	[illegible]	[illegible]	1.6	1.6	334	334	P. Lombardi	6	6	[illegible]	[illegible]	Organizational Meeting
3	0-161	[illegible]	[illegible]	1.6	3.4	334	[illegible]	P. Lombardi	6	12	[illegible]	[illegible]	Return to St. Louis
3	0-162	[illegible]	[illegible]	2.4	5.8	1101	[illegible]	–	–	12	–	[illegible]	Position a/c
3	0-163	[illegible]	[illegible]	2.8	8.7	1288	[illegible]	H. Crown	2	14	2576	11,084	Company Private
3	0-164	[illegible]	[illegible]	0.3	9.0	66	[illegible]		–	14	–	11,084	↓
5	0-165	[illegible]	[illegible]	0.3	9.3	66	[illegible]	L. Crown	1	15	66	11,150	↓
6	0-166	[illegible]	[illegible]	0.3	9.5	66	[illegible]	H. Crown	3	18	198	[illegible]	↓
6	0-167	[illegible]	[illegible]	0.2	9.7	66	[illegible]	↓	2	20	132	[illegible]	↓
6	0-168	[illegible]	[illegible]	2.2	11.9	880	[illegible]	↓	2	22	1760	[illegible]	↓
7	0-169	[illegible]	[illegible]	0.8	12.7	[illegible]	[illegible]	H. Crown	1	23	[illegible]	[illegible]	Board Meeting
7	0-170	[illegible]	[illegible]	0.7	13.4	236	[illegible]	↓	1	24	236	[illegible]	Return from Board Meeting
7	0-171	[illegible]	[illegible]	0.7	14.1	[illegible]	[illegible]	–	–	25	–	[illegible]	Return to St. Louis
8	0-172	[illegible]	[illegible]	1.7	15.8	774	[illegible]	A. [illegible]	4	29	[illegible]	[illegible]	Red Team Meeting Pax Pick up
9	0-173	[illegible]	[illegible]	0.9	16.7	315	[illegible]	↓	5	34	1575	[illegible]	Red Team Meeting - [illegible]
10	0-174	[illegible]	[illegible]	2.3	19.0	1020	[illegible]	↓	5	39	5100	[illegible]	Return to St. Louis
13	0-175	[illegible]	[illegible]	2.0	21.0	913	[illegible]	D. S. Lewis	3	42	2740	27,1[illegible]	Business Round Tbl. [illegible]

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GENERAL DYNAMICS

ATTEST: T. F. [illegible]
Manager/Chief Pilot

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

NUMBER OF PASSENGERS

MONTH June 1977

AIRCRAFT NUMBER N[illegible]

/C No.	Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
	16	0-176	LGA	Camp Springs, Md ADW	0.8	21.8	219	[illegible]	D. S. Lewis	1	42	219	27,360	White House Briefing ~~F-16 [illegible]~~
	16	0-177	ADW	Ft. Worth FWH	2.9	24.7	1334	15,780	D. S. Lewis	1	43	1334	28,694	F-16 Briefing
	16	0-178	FWH	STL	1.4	26.1	583	16,363	D. S. Lewis	1	44	583	29,277	Return to St. Louis
	17	0-179	STL	Providence R.I. PVD	2.4	28.5	1035	17,398	D. S. Lewis	5	49	5175	34,452	Electric Boat Launch
	18	0-180	PVD	Groton Ct. GON	0.2	28.7	43	17,441		-	49	-	34,452	Relocate a/c
	18	0-181	GON	STL	2.6	31.3	1030	18,471		6	55	6180	40,632	Return to St. Louis
	22	0-182	STL	STL	1.0	32.3	403	18,874	J. [illegible]	1	56	403	41,035	Maintenance Test
	23	0-183	STL	[illegible]	1.9	34.2	912	19,786	D. S. Lewis	6	62	5472	46,507	Present Century System
	25	0-184	[illegible]	STL	2.1	36.3	929	20,715	C. Fiske	4	66	3716	50,223	Return to St. Louis
	26	0-185	STL	DCA	1.6	37.9	756	21,471	W. Sullivan	7	73	5292	55,515	Fed. Mediation & Conciliation Mtg.
	26	0-186	DCA	STL	1.9	39.8	730	22,201	W. Sullivan	6	87	[illegible]	58,515	Return to St. Louis
	30	0-187	STL	[illegible]	1.8	41.6	801	23,002	L. Josephs	6	93	4806	63,321	Company Private
	30	0-188	[illegible]	St. Louis STL	1.8	43.4	771	23,773	-	-	93	-	63,321	Return to St. Louis

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GENERAL DYNAMICS

ATTEST: Leon J. Board —
Manager/Chief Pilot

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

MONTH July 1977

Sabreliner

NUMBER OF PASSENGERS

AIRCRAFT NUMBER [illegible]

Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
3	8-189	[illegible]	[illegible]	1.8	1.8	771	771	-	-	-	-	-	Position aircraft
3	8-190	[illegible]	[illegible]	.6	2.4	75	846	D.S. Lewis	5	5	375	375	Pick up passengers
3	8-191	[illegible]	[illegible]	1.6	4.0	746	1592	D.S. Lewis	6	11	4476	4851	Return to St. Louis
6	8-192	[illegible]	[illegible]	.7	4.7	257	1849	-	-	11	-	4851	Position aircraft
6	8-193	[illegible]	STL	.8	5.5	269	2118	H. Crown	4	15	1076	5927	Board of Dir. Meeting
7	8-194	STL	[illegible]	.6	6.1	257	2375	H. Crown	5	20	1285	7212	Return Passengers
7	8-195	[illegible]	[illegible]	2.0	8.1	873	3248	D.MacDonald	1	21	873	8085	Return Passengers
7	8-196	[illegible]	[illegible]	3.1	11.2	1035	4283	-	-	21	-	8085	Return to St. Louis
8	8-197	[illegible]	[illegible]	.5	11.7	201	4484	J. Rogerson	1	22	201	8286	Maint. Test Flight
12	8-198	[illegible]	[illegible]	1.2	12.9	374	4858	J. Legge	2	24	748	9034	Pax pickup enroute to
12	8-199	[illegible]	[illegible]	1.4	14.3	496	5354	J. Beggs	3	27	1488	10,522	F16/011 Discussions
13	8-200	[illegible]	[illegible]	1.4	15.7	496	5850	J. Beggs	3	30	1488	12,010	Drop pax after meeting
13	8-201	[illegible]	[illegible]	1.2	16.9	374	6224	J. Beggs	2	32	748	12,758	Return to St. Louis
14	8-202	[illegible]	STL	.2	17.1	30	6254	-	-	32	-	12,758	Ferry to Rockwell-Hein
16	8-203	STL	[illegible]	.2	17.3	30	6284	-	-	32	-	12,758	Return to Spirit
19	8-204	[illegible]	BEC	.8	18.1	384	6668	D.S. Lewis	7	39	2688	15,446	Beechcraft Factory Vis

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GENERAL DYNAMICS

ATTEST: T. J. Gordon
Manager/Chief Pilot

CORPORATE FLIGHT DEPARTMENT
Sabre
TRIP LOG

Member or Managers

MONTH December 1977

AIRCRAFT NUMBER N[illegible]

Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
1	5279	STL	TPA	2.8	2.8	897	897	H. Crown	2	2	1794	1794	Rtrn. Mr. Jenner fm
1	"	TPA	MIA	.8	3.6	209	1106	H. Crown	1	3	209	2003	Rtn. Mr. Crown fm Bd.
1	"	MIA	TPA	.8	4.4	209	1315	-	-	3	-	2003	Drop Mr. Jenners lugga
1	"	TPA	STL	2.3	6.7	897	2212	-	-	3	-	2003	Return to St. Louis
2	"	STL	MDW	.8	7.5	256	2468	L. Crown	2	5	512	2515	Return Pax from [illegible] Meeting Club
2	"	MDW	SUS	.9	8.4	267	2735	-	-	5	-	2515	Return A/C to Spirit
2	5280	SUS	TPA	2.4	10.8	877	3612	G. Fiske	1	6	877	3392	Site Acquisition Mtg.
2	"	TPA	HSV	1.5	12.3	567	4179	"	2	8	1134	4526	Site Acquisition Mtg.
2	"	HSV	BNA	.6	12.9	104	4283	"	2	10	208	4734	Drop Pax after Acq. M
2	"	BNA	SUS	1.2	14.1	323	4606	"	1	11	323	5057	Return to St. Louis
4	5281	SUS	YUL	2.2	16.3	961	5567	G. Fiske	4	15	3844	8901	Asbestos Bd. Meeting
5	"	YUL	MCI	3.1	19.4	1162	6729	"	2	17	2324	11225	Fuel Stop enroute to L
5	"	MCI	LAS	3.0	22.4	1159	7888	"	2	19	2318	13543	USITA Conference
7	"	LAS	SAN	1.0	23.4	285	8173	"	2	21	570	14113	Site Acquisition Mtg.
8	"	SAN	SJC	1.5	24.9	423	8596	"	2	23	846	14,959	" " "
8	"	SJC	SMX	.7	25.6	205	8801	"	4	27	820	15779	" " "
9	"	SMX	SJC	.7	26.3	193	[illegible]	"	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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Page 2

GENERAL DYNAMICS

ATTEST: Lamp ?. Gordon
Manager/Chief Pilot

CORPORATE FLIGHT DEPARTMENT

Sabre
TRIP LOG

MONTH December 1977

NUMBER OF PASSENGERS

AIRCRAFT NUMBER N2440G

lt	Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Passenger Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
	9	S201	San Jose SJC	San Fran. SFO	.3	26.6	37	9031	G. Fiske	2	33	74	16625	Site Acquisition Mtg.
	9	"	San Fran. SFO	Los Angeles LAX	1.1	27.7	330	9361	"	2	35	660	17285	Position A/C for Pax
	10	"	Los Angeles LAX	St. Louis SUS	3.3	31.0	1564	10925	"	4	39	6256	23531	Return to St. Louis
	12	S202	St. Louis SUS	OK City TIK	1.3	32.3	467	11392	R. Woodle	1	40	467	23998	Pick Up Iranian VIP's
	12	"	OK City TIK	Ft. Worth FWH	1.0	33.3	189	11581	"	6	46	1134	25132	Dinner Mtg. w/VIP's
	12	"	Ft. Worth FWH	St. Louis SUS	1.4	34.7	583	12164	-	-	46	-	25132	Return to St. Louis
	12	S203	St. Louis SUS	Ft. Worth FWH	1.7	36.4	583	12747	J. Beggs	3	49	1749	26881	Dinner Mtg. w/VIP's
	13	"	Ft. Worth FWH	St. Louis SUS	1.4	37.8	583	13,330	"	4	53	2332	29213	Return to Spirit
	17	S204	SUS	SUS	1.3	39.1	449	13779	-	-	53	-	29213	Training Flt - T. Garc
	17	S205	SUS	Chicago ORD	1.5	41.6	273	14052	SAS	3	56	819	30032	Company Private
	17	"	ORD	SUS	1.1	42.7	308	14360	-	-	56	-	30032	Return to Spirit
	21	S206	SUS	Wash. D.C. DCA	1.9	44.6	756	15116	D.S. Lewis	5	61	3780	33812	EB688 Program Mtg.
	21	"	Wash. D.C. DCA	SUS	2.3	46.9	750	15866	"	5	66	3750	37562	Return to St. Louis

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GENERAL DYNAMICS

ATTEST: Karen J. Buda
Manager/Chief Pilot

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

NUMBER OF PASSENGER

MONTH October 1977

AIRCRAFT NUMBER [illegible]

Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
18	S-268	DCA	SUS	2.0	27.3	766	11,118	D.S. Lewis	2	26	1532	15,855	Return to St. Louis
21	S-269	SUS	BOS	2.5	29.8	1110	12,228	T. Veliotis	3	29	3330	19,185	Return Pax from Planning
21	"	BOS	SUS	2.6	32.4	1110	13,338	-	-	29	-	19,185	Return to St. Louis
21	S-270	SUS	STL	.7	33.1	20	13,358	-	-	29	-	19,185	Position a/c for Pax PU
21	"	STL	MDW	1.0	34.1	256	13,614	L. Crown	4	33	1024	20,209	Return Planning Mtg. Mem
21	"	MDW	YUL	1.8	35.9	794	14,408	M.Taschereau	3	36	2382	22,591	Return Planning Mtg. Mem
21	"	YUL	STL	2.6	38.5	1002	15,410	-	-	36	-	22,591	Customs Clearance
21	"	STL	SUS	.2	38.7	20	15,430	-	-	36	-	22,591	Return to Spirit
24	S-271	SUS	ROC	1.9	40.6	761	16,191	H. Barlow	7	43	5327	27,918	S.C. Systems Review
24	"	ROC	SUS	2.1	42.7	761	16,952	-	-	43	-	27,918	Return to St. Louis
26	S-272	SUS	SSI Brunswick, GA	1.9	44.6	771	17,723	D.S. Lewis	2	45	1542	29,460	Company Private
26	"	SSI	SUS	1.9	46.5	771	18,494	-	-	45	-	29,460	Return to St. Louis
27	S-273	SUS	MDW	1.1	47.6	257	18,751	G.MacDonald	4	49	1028	30,488	Board Committee Meeting
27	"	MDW	YOW	1.3	48.9	673	19,424	G. Fiske	1	50	673	31,361	Asbestos Business Meeting
27	"	YOW	SUS	2.4	51.3	920	20,344	G. Fiske	1	51	920	32,281	Return to St. Louis
28	S-274	SUS	MDW	.7	52.0	256	20,600	J. Maguire	2	53	512	32,793	Retirement Comm. Meeti

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GENERAL DYNAMICS

CORPORATE FLIGHT DEPARTMENT

TRIP LOG

ATTEST: Lorenz F. Bunker
Manager/Chief Pilot

MONTH October 1977

number of passengers

AIRCRAFT NUMBER N[illegible]GC.

Date	Trip No.	From	To	Time	Total Time	Stat. Miles	Total Miles	Principal Pax	No. Pax	Total Pax	Pax Miles	Total Pax Miles	Purpose of trip
31	S-275	SUS	SBD	1.9	56.9	761	21,617	-	-	55	-	33,305	Company Private
31	"	SBD	SUS	2.1	57.0	761	22,378	D.S. Lewis	2	57	1522	34,827	Return to St. Louis

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DEFENSE CONTRACT AUDIT AGENCY
CAMERON STATION
ALEXANDRIA, VIRGINIA 22314

RECEIVED
10 [illegible]
RESIDENT AUDITOR
DCAA, GD/FW
FT. WORTH, TEXAS

27 OCT 19

IN REPLY REFER TO
PGD-22
701.4

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA

SUBJECT: Indirect Cost Monitoring Office (ICMO) Guidance Paper No. 80-1,
Company-Owned and Operated Aircraft

The enclosed ICMO Guidance Paper No. 80-1 was issued on 25 August 1980 to guide ACOs and auditors in negotiating and auditing the costs of owning, leasing, and operating aircraft. The ICMO is responsible for assuring uniform application of contracting policies and consistent treatment of cost allowability to promote timely and equitable settlement of overhead and advance IR&D/B&P agreements. Recent studies indicated problems were being experienced in negotiating company-owned aircraft costs, leading to inconsistent treatment among contractors. The guidance paper contains the following provisions that should help us audit these costs.

1. Advance agreement (DAR 15-107) is strongly encouraged where estimated costs allocated to DoD flexibly priced contracts are expected to be $500,000 or more.

2. ACOs are advised to disallow any unresolved costs due to manifest/log documentation deficiencies.

3. ACOs are encouraged to issue a "Notice of Intent To Disallow or Not Recognize Costs" (DAR 15-206) when documentation deficiencies are anticipated or confronted.

The paper sets forth minimum manifest/log documentation requirements. If a contractor's records do not meet these minimum requirements, the ACO should be notified immediately.

The ICMO has also recommended to the Office of the Under Secretary of Defense, Research and Engineering (OUSDR&E) that the CWAS indicator be removed from DAR 15-205.46, making aircraft costs subject to the test of reasonableness and that the entire CWAS program be reevaluated in light of the CAS 403 requirement of directly allocating cost. The study revealed that many contractors record aircraft costs as corporate G&A expense and then allocate the costs to segments on a direct usage basis. This direct allocation conflicts with the underlying concept of CWAS (i.e., costs are considered reasonable if the mix of business is predominately competitive), which presumes allocated costs will follow the mix of business at the corporate level, through a broad base allocation. However, when costs are directly allocated to segments doing substantial noncompetitive business, the reasonableness presumption is not valid. We will advise you of any action taken by OUSDR&E on these recommendations. In the interim, directly

ATTACHMENT D

PCD-22
SUBJECT: Indirect Cost Monitoring Office (ICMO) Guidance Paper No. 80-1,
Company-Owned and Operated Aircraft

allocated corporate G&A expense items should be scrutinized at CMAS-qualified contractors to determine if the above-described conflict with the CMAS concept exists. ACOs should be alerted of this condition, if noted, for consideration in future CMAS rating proposals.

As a voting member of the ICMO Working Group, DCAA strives to achieve the maximum possible consistency between negotiation decisions and audit determinations regarding indirect costs. Please advise us of any indirect costs receiving inconsistent treatment which you feel warrant the Working Group's study. Any cost issues fitting this criterion or any questions on this memorandum should be referred to Mr. Maurice Baxter, Audit Guidance Division, (202) 274-6343.

FOR THE DIRECTOR:

f. IRVING J. SANDLER
Assistant Director
Policy and Plans

Encl

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Memorandum Expiration Date: 21 October 1981

ATTACHMENT CD

Mr. WYDEN. The DCAA memo of the 1977 negotiations is Attachment B, dated April 9, 1981. It says that, "It became apparent that the CACO was following the prior years's negotiations in preparing his offer to General Dynamics. The auditor emphasized to the CACO that most of the questioned costs were considered unallowable and should not be subject to negotiations."

Mr. Modesitt, you were the CACO.

Mr. MODESITT. That's correct.

Mr. WYDEN. Is this correct? Did you base your position on the previous year's settlement?

Mr. MODESITT. No, I will tell you what I did. I went back as a matter of history to get a background because I knew nothing about the company. I had made an analysis of the previous year's negotiations, but my basis no one could determine, and the auditors certainly could not determine how I based my decision.

Now, I have given you the general criteria of how I made the decisions. If the results parallel, more or less, there certainly was some similarity, but it was not patterned or copied or anything like that from a previous year.

Mr. WYDEN. The auditor emphasized to you that most of the questioned cost was considered unallowable and should not be subject to negotiation. Now, do you agree that most of these questioned costs should not have been subject to negotiations and therefore are unallowable?

Mr. MODESITT. Well, I have spent many years as a contract auditor and prepared very many reports, and the auditor is entitled to an opinion, and I think the contracting officer certainly has to make the final opinion. Now, after reading the audit report and discussing it with the auditor, hearing the contractor's comments and reading his rebuttal, that in good faith a decision was made, and that is reflected in the figures that you see here.

The fact that the auditor recommended may or may not mean that they were correct—or let me put it this way—that they were right.

Mr. WYDEN. Did you think your predecessor did a good job in negotiating General Dynamics' overhead?

Mr. MODESITT. I really am not—I did not have enough time to really get into the program to make a determination, or that type of determination.

Mr. WYDEN. What do you think is behind this kind of "Catch me if you can" arrangement with the Government? It seems to me that was what was going on with General Dynamics. They put obviously unallowable costs in their overhead claims to the Government. Why do you think they would do that?

Mr. MODESITT. I don't know. The "Catch me if you can," I heard that this morning for the first time, so I'm kind of digesting that.

Mr. WYDEN. It's not a complicated concept, though.

Mr. MODESITT. No, I'm sure it isn't.

Mr. WYDEN. Why do you think it is done?

Mr. MODESITT. I don't know. I have negotiated overheads, a limited number over the past many years before doing this for General Dynamics. I would say that the General Dynamics overhead contained more, I would say, comingled and unallowable costs in the overhead proposal than did the contractors that I had previous experience with.

Mr. **Wyden**. So you think most of the other contractors are not involved in this kind of practice?

Mr. **Modesitt**. I wouldn't say most. I would say that I am thinking in terms of two contractors that I had previously negotiated with where the accounts were much cleaner than these accounts.

Mr. **Wyden**. Two others. So it's one out of three.

Mr. **Modesitt**. Yes.

Mr. **Wyden**. Who were the other contractors?

Mr. **Modesitt**. Bendix and Westinghouse.

Mr. **Wyden**. Another area of negotiations was a $500,000 questioned travel cost that DCAA said was primarily entertainment. However, you allowed General Dynamics $340,000 of the cost. Can you remember any details with respect to the situation?

Mr. **Modesitt**. Not really.

Mr. **Wyden**. Were you aware that this is the account that General Dynamics uses for questionable entertainment of governmental officials?

Mr. **Modesitt**. Yes, sir. I think all contractors use that account.

Mr. **Wyden**. Were you aware that many of these questioned costs were due to blank vouchers? And here we are talking about names of those who were entertained but not identified.

Mr. **Modesitt**. I know that is the practice.

Mr. **Wyden**. Again, why is anybody allowed to do this?

Mr. **Modesitt**. Why is a contractor allowed to do it? I don't know. I don't know how you would prevent him from accounting it in this way. I think the question is, is the cost allowed or given back, and I certainly would consider that matter.

Mr. **Wyden**. But you are allowing them the money in that kind of case.

Mr. **Modesitt**. You are presupposing that substantially all of the account was unallowable. I am not. I am not taking that tack. I think this is one of the problems we're having; that when there is an unallowable element of cost in the claim, that the whole thing is unallowable, and that's not necessarily so.

As I indicated before, when you have a comingled account, it's necessary to sort out as best you can——

Mr. **Wyden**. They were specifically questioned costs that you allowed.

Mr. **Modesitt**. Yes, sir, that's very possible. I have questioned costs as a contract auditor for years, and much of it was reinstated in negotiations.

Now, as I said to you, sir, this is an opinion and the final opinion is not made by the auditor. I can be much more liberal in my interpretation of what is unallowable and that sort of thing if I don't have to make the final opinion.

Mr. **Wyden**. Excuse me. You make the final opinion. You are the CACO. The buck stops there.

Mr. **Modesitt**. That's right. Yes, sir; that is absolutely correct.

Mr. **Wyden**. And again, we go back to the corporate aircraft issue that I just talked about a moment ago where we are essentially allowing many, many flights, 77 cents on the dollar, personal flights billed to the government, to and from Miami for Mr. Crown, flights to and from Brunswick, GA to shuttle Mr. Lewis to his former residence. The buck stops with you, and those look to me like very questionable payments that you allowed.

Mr. MODESITT. In my mind at the time this was concluded as in the case of every other negotiation.

Mr. WYDEN. We see that on one of these trips we were going to drop off Mr. Jenner's luggage in Miami and that was billed to the taxpayers.

Now, what would happen to a claim like that? I mean, it strikes me as a situation where clearly, there was an attempt to bill the taxpayers for that. Were they successful?

Mr. MODESITT. Specifically, on that item? I couldn't identify it, sir.

Mr. WYDEN. What about some of the Lester Crown meetings, TWA board meetings, for example?

Mr. MODESITT. I don't know how to answer the question. As I say, the items——

Mr. WYDEN. These are claims to the Government over which you passed judgment as to whether they were allowable. And again, they strike us as very questionable. And all the evidence indicates that you allowed these costs to be billed to the Government.

Mr. MODESITT. It doesn't indicate that to me, sir.

Mr. WYDEN. Well, there are no passenger lists, there's no indication who was being carried around, and there's no indication it was disallowed. And given the track record in this particular——

Mr. MODESITT. We are certainly having differences of opinion. I think it's evident that if nothing is disallowed the auditors advisor report would have been the final negotiation. And that is not the case. Do you understand what I'm saying? You're saying it appears that this was allowed and this was not. I gave the criteria initially where costs are comingled, unallowable and allowable, as best we can determine. They are set aside for purposes of negotiation by the negotiator and in this case, myself.

And I think you will find many costs in the proposal that are unallowable.

Mr. WYDEN. Well, you have attachment A, and they are not comingled; they are broken out in attachment A which you have. DCAA questioned costs—sustained in negotiation by CACO. And you signed it.

Mr. MODESITT. That's correct. That is correct.

Mr. WYDEN. It doesn't strike me as being anymore clear. I mean, those are questioned costs, not comingled. You allowed them. Taxpayers got taken by that.

Mr. MODESITT. Well perhaps what we should do—perhaps—in other words, I can make an opinion as an auditor. That's all I'm allowed. Therefore, thus it is so—it doesn't make it so.

I think what we're saying is this is an advisory report, and I think it's done by competent people with good intentions. But these reports are handing me and handing any contracting officer, here is a problem. Solve it. You do your best. You do your very best if you are conscientious, to do that. But in very few cases are the costs questioned sustained 100 percent.

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Mr. WYDEN. You were not just the auditor; you were the CACO. You made the final judgment. Is there any legal memo, for example, or anything else that justifies your position?

Mr. MODESITT. The memo that was sent to the auditor. My final position is in that memo. And there's also a memo of agreement with the contractor. That is it.

Mr. WYDEN. Mr. Modesitt, I am going to demand that the Navy open up this year's 1977 and previous year's settlements with General Dynamics. For example, for the 1976 year's settlement, the Navy allowed General Dynamics $1.7 million of $8 million in similarly disputed costs. And I think we have got to get at these matters. I think we have got to find out exactly how these billing procedures went.

[The following document was submitted:]

Prep. By Modesitt

[illegible] of Negotiations

General Dynamics 1974, 1975 & 1976

Corporate Office Overhead

	1974 Total Incurred	1974 Sustained	1974 Accepted	1975 Total Incurred	1975 Sustained	1975 Accepted	1976 Total Incurred	1976 Sustained	1976 Accepted
(1) Washington Office (See Attached) (2)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]			
Legal	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]			
Dues	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Communications	52171	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Exhibits	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Airplane Costs	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Corollary Corporations	[illegible]		[illegible]						
Travel	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Professional	81516	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	58675
Misc.	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]
[illegible] Transfer Services				[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Salaries							[illegible]	[illegible]	[illegible]
Directors Fee & Expense							[illegible]	[illegible]	[illegible]
Other Professional Services							[illegible]	[illegible]	[illegible]
Sub Total	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	3016781	[illegible]	1713000
Not Allowed	[illegible]			[illegible]			[illegible]		
Total	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1713000

Attachment E

Notes:
(1) See attached schedules for Washington office
(2) No exception to [illegible] allocation [illegible]

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Mr. Wyden. It seems to me that of these items that you had final judgment on, all the evidence points to the fact that many are matters that don't relate to the country's national defense and were billed to the taxpayer. And I want to yield to my colleagues for any questions they would like.

The gentleman from Texas.

Mr. Bryant. I will ask one.

Mr. Modesitt, was Admiral Sansone aware of the situation that was just described in the questions that Mr. Wyden asked?

Mr. Modesitt. Yes, I certainly think that he was. I believe that he was. You mean regarding the staffing?

Mr. Bryant. Well, with regard to the entire situation that we just went through with Mr. Wyden—Mr. Wyden just went through with you regarding the extent——

Mr. Modesitt. Oh, are you speaking of the negotiation, the 1-year negotiation?

Mr. Bryant. I'm speaking of the negotiations to settle out General Dynamics' claim, in particular in this area of negotiation, regarding the $500,000 travel expenses that were settled for $334,000.

Mr. Modesitt. No, sir, he would not have been.

Mr. Bryant. What is it you were referring to that he was aware of?

Mr. Modesitt. Original staffing of the job. I thought that was your question originally.

Mr. Bryant. The original staffing of the job?

Mr. Modesitt. The fact that the CACO had been removed and it was taken over on really a part-time basis.

Mr. Bryant. But you are saying that this admiral was never really aware of how this matter was settled?

Mr. Modesitt. No, sir; he would not have been.

Mr. Bryant. What military authority would have been?

Mr. Modesitt. There wouldn't have been any military authority that would have been involved.

Mr. Bryant. Well, once you were finished with it, nobody looked over your shoulder to see how good a job you did?

Mr. Modesitt. We do not have a formal business clearances or negotiated clearances. I don't know whether that happens now or not. At that time it did not.

Mr. Bryant. But you settled out the $500,000 in disputed travel expenses by paying General Dynamics $340,000, and no one ever reviewed that decision? Is that correct?

Mr. Modesitt. It was coordinated informally with my supervisor, but we did not prepare formal business clearances, a formal paper. Formally, the answer is no.

Mr. Bryant. When you said $340,000 is OK, somebody in the Government wrote a check for $340,000?

Mr. Modesitt. Well, no, sir; it doesn't quite work that way, but that is the bottom line. That is the net effect, though.

Mr. Bryant. Well, we have gone through all these questions here where you have talked about the difficulties in making all these judgments and decisions and all that stuff. You are the final authority on this. And for practical purposes you authorized the writing of the check. Who are we supposed to ask questions of if we are trying to get down to the problem of waste and abuse and fraud, cheating and stealing?

Mr. **Modesitt**. I would like to, if the committee is interested, offer some suggestions that might be helpful.

Mr. **Bryant**. I wish you would. And I will certainly let you do that in just a moment. But I want you to answer my question:

Who do we ask these questions of?

Mr. **Modesitt**. In this specific case? I guess you ask them of me. Does that answer your question? I'm sorry.

Mr. **Bryant**. I guess in a way it does, except that he asked them of you and we had a good bit of trouble getting you to give us concrete answers in regard to what ought to happen or what did happen.

Mr. **Modesitt**. Well, I'm not trying to be uncooperative on a specific item. They were asked item by item specifically, as Mr. Spanton asked the same thing. I can't really answer each specific item because the items in consideration of the amount that are believed to be unallowable were set-aside and not considered in the reimbursement.

Mr. **Bryant**. Well, let me ask you this: Is there a document somewhere in which there is a list of all of the questionable or at least questioned travel costs that you have gone over and that you have said: "This one is OK, this one is not OK, this one is OK, this one is not OK," and then added up all the ones that were okay and it added up to $340,000?

Mr. **Modesitt**. The auditor's report would have been the basis. The audit report would most likely be the one that we would work from, the auditor's report.

Mr. **Bryant**. So, the auditor's report would go down that list of expenses and say this one is in, this one is out, this one is in, this one is out?

Mr. **Modesitt**. No. I am saying that as a springboard or to get to that figure, we would probably use the audit report, but it would be on a worksheet. I have said to the auditors somewhere here, this was just handed to me, I'm not that familiar with the location of everything in it, a listing, but every detailed line item, I don't think you would find that in a negotiation report, sir.

Mr. **Bryant**. But the size of these expenses is so huge individually, how could you ignore them?

Mr. **Modesitt**. Well, sir, if I ignored them, it was inadvertent. I don't believe that I did.

Mr. **Bryant**. Well, I'm not suggesting you're any different from anyone else, and I hope you won't take this as any personal inquisition, but the system which you were sitting on top of as the CACO, and which presumably other CACO's are sitting on top of, does not require anyone down below to look at each of these individual questioned costs and determine whether they are fair or not? In fact, you don't even demand to know, or you made decisions without even knowing who was on the airplane when you looked at the cost of flying airplanes back and forth.

I am asking where does the scrutiny come in. Nobody ever looks at it, do they? Is that correct, nobody ever looks at it?

Mr. **Modesitt**. Looks at what? The negotiation report or the work that I did?

Mr. BRYANT. The individual expenditures, one by one, for taking Henry Crown to wherever you took him, or taking David Lewis to wherever you took him.

Mr. MODESITT. The auditors would be the ones who would look at that.

Mr. WYDEN. Would the gentleman yield?

Mr. BRYANT. Yes.

Mr. WYDEN. I appreciate the gentleman yielding.

You have the last word, and as far as I can tell, you gave away millions of dollars of the taxpayers' money without having a legal memorandum or any written authority to justify it. And I think you are aware that the General Accounting Office is very critical of the way you handled things, and I am still looking for some kind of written authority that would justify handing out these millions of dollars of the taxpayers' money. It doesn't exist, does it?

Mr. MODESITT. A legal document?

Mr. WYDEN. A written statement, a legal memorandum justifying these charges. It doesn't exist.

Mr. MODESITT. No, I don't know of any memorandum.

Mr. BRYANT. Mr. Chairman, I would like to ask Mr. Modesitt what I assume is the case already, that in handling this matter we are discussing as an example right now, you were following the procedures, I assume, that everybody else followed in the whole industry. We are not aiming at or suggesting that you did any different. Are we right to believe that you did it like the others do it?

Mr. MODESITT. I would say that the negotiation of overhead at that point in time—and I suspect still today—there is a pattern in which you arrive at conclusions and make decisions, and they are established based on the experience that you have at that time. Yes, sir; that is correct.

Mr. BRYANT. You gave a rather long answer, but in sum, what you said is that everybody else is doing it the same way you did it, or was doing it when you were there?

Mr. MODESITT. I would say generally, yes.

Mr. WYDEN. That is a shocking answer. I mean what you are just saying is we will make decisions without regard to law——

Mr. MODESITT. No, sir; I did not say that.

Mr. WYDEN. Well, how do you do it, then? You just extrapolate from the past, based on that last answer to the gentleman from Texas, and everybody else is doing it, so that's the way you think we ought to do it?

Mr. MODESITT. No; I said that the pattern over a period of time, because there is a pattern in which the way things are done, and there is a point in time at which something is considered reasonable or even right or wrong, and that does change periodically.

I think there is a pattern. There has to be some method because everyone would go off in different directions. There would be no uniformity in settling overheads.

Now in that sense, that is what I alluded to.

Mr. BRYANT. Well, it seems clear that everybody does go off in different directions. I have yet to hear a standard criterion for judging these very large questioned expenditures. Go ahead and tell us—I cut you off in order to complete my question—what your recommendations are.

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Mr. MODESITT. All right. What I would like to say, gentlemen, is this:

There are in cost principles some very fine cost principles that are clearly stated and they are easy. They really don't cause a great number of problems. There are a number of them. They certainly need, in my view, to be rewritten because it leaves this sort of thing wide open and gives you no real guidance on how to settle an item of cost.

I think aircraft cost is a very good item. Travel and entertainment is another one, where there are just horrendous problems with it. I think that the thinking would have to be that we decide that we will pay so much aircraft cost regardless of how many planes you have or what your cost is, and you have it clearly stated.

Much of the problem that we are having today, not all, but much of the problem, would be cleared up in the future. I don't believe that with the cost principles, a number of them with such wide interpretations as evidenced by the number of cases at the board, that you are going to get the best judgment is certainly subject to a great deal of criticism, and perhaps it is the best you can do at the time, but I think it needs to be—the cost principles need to be rewritten, a number of them.

Mr. BRYANT. If you were representing a business and this matter was before you, I have no doubt but what you would turn down the entire travel expense and force General Dynamics to sue you over it in the courthouse, knowing that they would then have to settle the thing inexpensively because they probably couldn't win their suit.

What happens if you, in the Government setting here, refuse to approve that $500,000 of travel allowances? What would have happened?

Mr. MODESITT. It could be forced into the Board of Contract Appeals.

Mr. BRYANT. What is wrong with doing that?

Mr. MODESITT. Well, I am reluctant to make a suggestion, but I will. I don't think that is the place. The batting average is very poor. I think if we want to correct it, that's what would happen. And again, when I find something that is distasteful to me and I force it on the Board of Contract Appeals, and their batting average is terrible.

Mr. BRYANT. Well, it's not a matter of being distasteful. I'm not saying you should do it because it's distasteful.

Mr. MODESITT. Well, perhaps that's the wrong choice of words. If I have a difficult problem and I can't solve it, I suppose I could force it on the Board of Contract Appeals.

Mr. BRYANT. What if you just say you don't think these are justified? "You guys destroyed the trip list; nobody knows who is on the airplane, so too bad, you're going to eat this one."

Why can't you just do that? They destroyed the trip list. How can you possibly judge whether it was worthwhile or not?

When I was an attorney practicing law and I sent out an itemized bill, if I didn't include everything on the bill that I had done, I didn't expect to get paid. Now they didn't include it on their bill.

They just said airplane trip. They didn't say who was on the plane. Why can't you say no, sorry, not good enough?

Mr. MODESITT. Well, as I said, I think forcing things into the Board of Contract Appeals is not necessarily the way to solve the problem, at least in the future. I think the cost principles need to be revised and clarified and there are very broad interpretations on many of them, and it makes it very difficult to arrive at a decision.

Mr. BRYANT. Who is on that contract board? Who makes up that board?

Mr. MODESITT. I really don't know, sir. The Board of Contract Appeals?

Mr. BRYANT. I mean are they military people or civilians? Who are they?

Mr. MODESITT. I believe they are civilians, attorneys. I'm sure that you probably have more data than I do. I mean as to the composition. I don't really know.

Mr. WYDEN. The gentleman from Minnesota.

Mr. SIKORSKI. Thank you, Mr. Chairman.

Mr. Modesitt, it seems to me that it is important for the record to have in it the copy of the letter and the concern reflected in the GAO's letter to the Secretary of Navy on this problem. They say, the purpose of this letter is to bring to your attention lack of documentation to support negotiation decisions for costs incurred at the General Dynamics corporate office, St. Louis, MO. And it goes on to say, in April 1981, the corporate administrative contracting officer, the CACO, headquarters Navy Materiel Command, Washington, DC, negotiated incurred expenses for the General Dynamics corporate office for calendar year 1977. DCAA questioned the reasonableness, allowability, or applicability of $4,599,215 of the proposed $23,936,871 cost. Negotiations with the contractor resulted in a disallowance of only $1.5 million of the questioned costs. The CACO prepared a document showing the costs disallowed. However, this document did not show the basis for allowing or disallowing costs questioned by the DCAA.

So, everyone is left in the bind. It seems to me one reform would be to require that in a disallowance negotiated situation, what is approved and what is not approved or the ratio be set out and supported, just as in any kind of settlement. Is that one that you would embrace?

Mr. MODESITT. I would.

Mr. SIKORSKI. It seems to me you are part of the victimization that is occurring in this process. You get people in and an assistant comes in. You mention the people above, and the people below and others and the tremendous constraints to act with integrity and perserverance and hold on to something, and to follow it through.

Overall do you think the Navy put you in an unfair position when you were made CACO in this instance?

Mr. MODESITT. Yes; I do.

Mr. SIKORSKI. And do you think Admiral Sansone was aware of this situation?

Mr. MODESITT. Yes; I do.

Mr. SIKORSKI. And is it indeed the same admiral that is now heading the Navy's Gratuities Board?

Mr. MODESITT. I don't know where he is at this time.

Mr. **Sikorski**. You don't know of another Admiral Sansone?

Mr. **Modesitt**. No; I only know one.

Mr. **Sikorski**. And should there be one heading the Navy Gratuities Board, it would probably be this guy; right?

Mr. **Modesitt**. I would think so. He is at least the only one I know of.

Mr. **Sikorski**. You made the settlement and then you retired; is that correct?

Mr. **Modesitt**. Shortly thereafter, yes.

Mr. **Sikorski**. How shortly?

Mr. **Modesitt**. Well, I forget the date. It was within a month or so, yes, sir. There is no relationship between the two. I had planned to retire for a long time before that.

Mr. **Sikorski**. No; I would suggest that perhaps if there is a relationship, it went to your original appointment in the first place. And if there is a relationship at all, you were scheduled to retire that date——

Mr. **Modesitt**. I had planned to quit a long time before that, yes, sir.

Mr. **Sikorski**. I thank you.

Mr. **Bryant**. I just wanted to clarify your last comment. As I understood what you were saying, you were suggesting that perhaps his appointment as CACO in this matter was because of the fact that he was about to retire and therefore having this General Dynamics matter would finish it, retire, and he'd no longer have to account for it? Whereas anyone else who was going to stick around would have to account for the work that they had done, to us, perhaps, and to the Agency? Is that what your suggestion was?

Mr. **Sikorski**. My suggestion was that the facts—I don't think this is the only instance where you have people who are on the retirement path who are put into a position of cleaning something up before they leave, and the pressures become extensive. And we have already heard the testimony of lack of resources and documentation and the rest of it, and he is not around to defend it, he is not around to cry foul, and the system is discharged. The individual is responsible, and the company goes merrily along on its way.

Mr. **Wyden**. Would the gentleman yield?

Mr. **Sikorski**. Surely.

Mr. **Wyden**. I think the gentleman from Minnesota makes an excellent point, and it is my understanding that your predecessor, settled and retired the next day. So, I think that the point that the gentleman from Minnesota is making is that the system is clearly not conducive to dealing with these in a responsible way. Does the gentleman from Minnesota have anything else?

Mr. **Sikorski**. No; I thank you.

Mr. **Wyden**. Unless the minority counsel wishes to ask any questions, or unless the gentleman has further comments, the gentleman is excused.

The subcommittee will stand adjourned until 10 o'clock tomorrow morning.

[Whereupon, at 5:50 p.m., the subcommittee was adjourned, to reconvene Wednesday, April 24, 1985.]

FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING

WEDNESDAY, APRIL 24, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Oversight and Investigations,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2322, Rayburn House Office Building, Hon. Ron Wyden presiding (Hon. John D. Dingell, chairman).

Mr. Wyden. The subcommittee will come to order.

The Subcommittee on Oversight and Investigations today continues its hearings into the accounting practices of defense contractors.

During our investigations of General Dynamics and Pratt & Whitney, this subcommittee has uncovered a whole host of frauds and rip-offs against the American taxpayer. We now know that the defense procurement system, specifically overhead accounts, can be used to make taxpayers fork over millions of dollars for wining, dining and high living.

What is most deplorable is that even though the Pentagon and its auditors hold all the cards, the contractors invariably end up with the winning hand.

It seems that the Pentagon's Inspector General is mostly interested in press releases that give the appearance of action, when very little is happening.

The GAO inexplicably fails to publish a critical report on the procurement system, and then finally goes after planned audit coverage, rather than actual audit coverage.

The DCAA refuses to kick out or even look at the vouchers behind overhead charges submitted for reimbursement. Instead, they automatically give contractors up to 70 cents on the dollar for obviously unallowable expenses.

It is no wonder that the contractors throw everything but the kitchen sink into these overhead accounts.

We have heard a lot of talk at the subcommittee about investigators and auditors being meaner than junkyard dogs, but in reality what we have heard so far is that too many of them act more like tabby cats.

What the American people have gotten so far is lame excuses and empty pockets, and this subcommittee is dedicated to turning that situation around.

On April 16, 1985, Chairman Dingell asked the Secretary of the Air Force to make the Air Force Management Systems Deputy available for testimony before our subcommittee in his official capacity. We asked that Mr. Fitzgerald's official statement be cleared for open publication, and that it be furnished us on Friday, April 19, 1985.

We also provided the Secretary the opportunity that if he did not agree with Mr. Fitzgerald's prepared statement, to annotate a copy of Mr. Fitzgerald's prepared statement, showing what he believed to be the correct facts and submit the annotated copy to us over the Secretary's signature.

The Secretary of the Air Force has not complied with the committee's request. Frequent phone calls by the subcommittee's staff to Pentagon officials up and down the line have still not produced the statement which has been cleared for open publication.

The subcommittee believes that the Air Force is trying to avoid accountability by pretending that the findings of Mr. Fitzgerald and his associates in their official reviews can be dismissed by labeling them "personal views."

The subcommittee believes the Air Force is wrong. They are not going to dodge the serious issues raised by Mr. Fitzgerald and others.

Furthermore, this subcommittee, and specifically Chairman Dingell, will not permit the Pentagon to misuse the security clearance process to hide the truth.

Therefore, we are postponing Mr. Fitzgerald's testimony until his statement is cleared properly.

I would like to recognize at this time the gentleman from Minnesota for any opening statement that he would like to make.

Mr. SIKORSKI. Thank you, Mr. Chairman.

Since the subcommittee began its investigation, we have heard the American taxpayers have been billed for millions of dollars in overcharges for everything from swanky parties to chartered fishing trips, to $5,000 therapy sessions, and 200 dozen golf balls.

Defense contractors testified that those overcharges are appropriate and legal. We heard Secretary Weinberger on national TV announce a new get-tough policy that has amounted to nothing but hot air.

We saw the Secretary's newest version of the game of Monopoly, in that defense contractors don't have to swear to tell the truth when they bill the taxpayers. There are no penalties for lying. They just pass go and collect billions from the taxpayers.

We have heard how defense contractors have wined and dined the very officials responsible for protecting the taxpayers' investment, and how those officials swing through the revolving door into high paying defense industry jobs.

We have heard Secretary Weinberger tell us that General Dynamics is the exception, not the rule. But yesterday Pratt & Whitney provided the same sorry litany, and today we will hear from the General Accounting Office describing how their audits of 12 major contractors showed that DOD pays millions in questionable overcharges year after year.

Yesterday we heard George Spanton explain how DCAA refused to help him get the documentation he needed to make the case against Pratt & Whitney.

Today the GAO will corroborate his testimony, stating that Pentagon negotiators often are denied access to contractor documents by the contractors.

We heard how one-third of our defense procurement budget is wasted. That is $42 billion that the deficit could be reduced.

And finally, we heard an FBI agent repeatedly refuse to answer the subcommittee's questions about his investigation of fraudulent activities on the part of Pratt & Whitney. His bosses at the Bureau, in line with the Justice Department, would not let him speak. Just as the U.S. Attorney in Miami refuses to move the case forward, just as George Spanton's bosses threatened to fire him for trying to change the system, for trying to enforce the law, and just as Mr. Fitzgerald has been muzzled by the Air Force today.

Mr. Chairman, I again thank you and the staff for conducting the hearings. They have uncovered widespread fraud and raised the spectre of staggering military-industrial collusion. They have identified systemic problems in DOD's auditing procedures which allow unscrupulous defense contractors to steal from the American taxpayers and discourage conscientious auditors from investigating those abuses.

I hope our witnesses fully understand the seriousness of our concerns. I want the Defense Department Inspector General to explain why they allow this wholesale scalping to continue, and I want the administration to know that it, too, is on notice that the American people are tired of funding this wheel of fortune for defense contractors.

Thank you.

Mr. WYDEN. I thank the gentleman.

Does the gentleman from New Jersey care to make an opening statement?

Mr. FLORIO. Mr. Chairman, I will put my statement in the record.

Mr. WYDEN. So ordered.

[The prepared statement of Mr. Florio follows:]

STATEMENT OF HON. JAMES J. FLORIO

Mr. Chairman, I would like to point out the vital importance which this hearing and others of this type can play in our national debate about the validity of the defense budget and its effect upon the deficit problem.

There are not many people in America who are unaware of the intrinsic connection between the recent unprecedented defense expenditures and the equally as unprecedented budget deficits. Certainly no one is against an adequate and strong defense for our Nation. This point needs no clarification.

What I have found, time and again—up in my district office in New Jersey—is that a significant number of people are wondering just how well all of those billions of defense dollars are being spent. This question raises many concerns with me and I am happy to have the chance to listen to and question the distinguished panel from the General Accounting Office. I commend you, Mr. Chairman, on your leadership regarding this issue and I look forward to the gentlemen's statements.

Mr. WYDEN. Our first panel will be Mr. Frank C. Conahan, Director, National Security and International Affairs Division in the General Accounting Office, and accompanying him is Mr. Clark

Adams, Group Director, Research Development, Acquisition, and Procurement Group of the General Accounting Office.

Gentlemen, if you would come forward.

Gentlemen, as you know, it is a practice of the subcommittee to swear all witnesses. Do either of you gentlemen have any objection to that?

Mr. CONAHAN. No, sir.

Mr. ADAMS. No, sir.

[Witnesses sworn.]

Mr. WYDEN. Gentlemen, again, pursuant to subcommittee practice, I am to advise you of the right to counsel and the right to a copy of the Rules of the House of Representatives, and the rules of the committee. We will make, gentlemen, a full copy of your prepared remarks a part of the hearing record, and you may proceed as you wish, highlighting substantial concerns you may have, or proceed in any fashion that you deem appropriate.

[The following material was submitted:]

U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

April 14, 1983

The Honorable Verne Orr
Secretary of the Air Force
Department of the Air Force
The Pentagon
Washington, D. C. 20330

Dear Secretary Orr:

I want to let you know that your Management Systems Deputy, Mr. A. E. Fitzgerald, has been providing valuable assistance to the staff of the Subcommittee on Oversight and Investigations in the Subcommittee's ongoing investigations of government contractors' performance disclosures and adequacy of books and records. Your permitting Mr. Fitzgerald and his staff to continue this assistance is greatly appreciated. In addition to being helpful to the Subcommittee, Mr. Fitzgerald has advised me that the insights gained through his involvement with the Subcommittee are proving to be of great value to his office and the Air Force as well. This is indeed encouraging.

When the Subcommittee first requested the assistance of Mr. Fitzgerald's office in this matter, we did not anticipate that our inquiries would lead us into areas involving Mr. Fitzgerald's Department of Defense (DOD) duties. Consequently, we informed you that Mr. Fitzgerald might be called upon to offer explanatory testimony, but not as an official witness speaking on behalf of the DOD. We have found, however, that the Subcommittee's oversight activities have carried into areas involving Mr. Fitzgerald's DOD work. Mr. Fitzgerald's testimony in his official capacity would be very helpful to the Subcommittee since it is important for the Subcommittee to know how well the DOD's different organizational parts work together in pinpointing waste and abuse, and hopefully, in resolving the problem areas. I am particularly interested in how well the audit and investigative organizations perform in internally controversial situations. Mr. Fitzgerald has indicated that he has a good case study of such a situation.

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We have scheduled Mr. Fitzgerald's appearance for Tuesday, April 23, 1985, at 10:00 a.m. Please see that 50 copies of his prepared statement, officially cleared for open publication, are delivered to our Subcommittee by 5:00 p.m. on Friday, April 19, 1985. If you do not agree with any of the specific facts in Mr. Fitzgerald's prepared statement, please annotate a copy of Mr. Fitzgerald's prepared statement showing what you believe to be the correct facts and submit the annotated copy to us over your signature, along with Mr. Fitzgerald's prepared statement. Please do the same with any policy differences you might have.

Again, thank you for your cooperation in this matter. We are most gratified by the results to date, and look forward to continuing our constructive cooperation.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:PScm

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DEPARTMENT OF THE AIR FORCE
[illegible]

OFFICE OF THE UNDER SECRETARY

April 22, 1985

Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This responds to your letter of April 16, 1985, in which you request the presence of Mr. A. Ernest Fitzgerald to testify "in his official capacity," on April 23, 1985.

While the Air Force is, and has been, willing to make Mr. Fitzgerald available to testify before Congress as an Air Force employee acting in his official capacity, we have consistently taken the position that it is the prerogative of the Department of the Air Force to determine who will appear before the Congress to present the official views of the Department.

The second paragraph of your letter refers to the Subcommittee's desire to have testimony on "how well the DOD's different organizational parts work together in pinpointing waste and abuse, and hopefully, in resolving the problem areas." If, by this, you intend to request official views from the Department of Defense on this subject, such request should be directed to the Secretary of Defense who would determine who, in the Department of Defense, is best qualified to present the Department's official views on this subject. If, on the other hand, the Subcommittee desires the official views of the Department of the Air Force on this subject, I would be happy to designate a witness to appear before the Subcommittee to present the Air Force position on these matters.

The Air Force will make Mr. Fitzgerald available to testify in his official capacity as Management Systems Deputy. He may appear before your Subcommittee to testify as he sees fit; however, you should understand that he will not be appearing to present the views of either the Department of Defense or the Department of the Air Force and that the views and opinions he may express do not necessarily represent the official views and opinions of either the Department of Defense or the Department of the Air Force.

I am gratified to learn that Mr. Fitzgerald's previous assistance to your Subcommittee has been so helpful and appreciate your passing along this information. I hope that his forthcoming appearance will be equally beneficial.

Sincerely,

E.C. Aldridge Jr.
E. C. Aldridge, Jr.

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. 20330

OFFICE OF THE ASSISTANT SECRETARY

22 April 1985

MEMORANDUM FOR COLONEL PINCKNEY, SAFFM

SUBJECT: Witness Statement for A. Ernest Fitzgerald

As I mentioned to your on Friday, I don't understand why General Bernie Weiss or other Air Staff officials or offices have to approve my proposed Congressional statement. I don't approve theirs and I believe that I am supposed to be at least equal in rank or standing to a 3-star general. I have no particular desire to coordinate on Congressional statements of others, but I don't see why we allow this demonstrably nonproductive review to hold up our work.

Now I have learned that my proposed statement has been sent to the Air Staff as well as OSD. Therefore, in the interest of trying to make the process productive and also to save time, I propose that we gather together the addressees both to present their written responses and to give me any verbal explanation needed all at once. Specifically, I should like to hear comments separated into two categories:

1. Factual disagreements

2. Policy differences

Please let me know about timing for this requested meeting as soon as possible so that I can make sure to schedule time for it before I go home tonight.

A. E. FITZGERALD
Management Systems Deputy

Copy to:
Mr. Carver
Mr. Harshman

DEPARTMENT OF THE AIR FORCE
WASHINGTON 20330

OFFICE OF THE ASSISTANT SECRETARY

19 April 1985

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)
INSPECTOR GENERAL, DOD
ASSISTANT SECRETARY OF THE AIR FORCE (RESEARCH DEVELOPMENT & LOGISTICS)
DEPUTY CHIEF OF STAFF, RESEARCH DEVELOPMENT & ACQUISITION, AF/RD
COMPTROLLER OF THE AIR FORCE, AF/AC

SUBJECT: Witness Statement for A. Ernest Fitzgerald

Representative Dingell, Chairman of Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, has requested Mr. A. Ernest Fitzgerald to testify on 24 April 1985 (Attachment 1).

Mr. Fitzgerald's proposed statement is at Attachment 2.

Request your coordination or comments on the proposed statement be provided this office as soon as possible.

The Committee has been advised their requested 19 April 1985 suspense cannot be met but we will appreciate your expeditious handling and coordination by COB 22 April 1985.

RICHARD E. CARVER
Assistant Secretary of the Air Force
(Financial Management)

Attachments

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

22 [illegible] 1985

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT)

SUBJECT: Testimony of Mr. A. Ernest Fitzgerald, April 24, 1985, before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce

We have reviewed Mr. Fitzgerald's testimony and find the last two paragraphs of the statement to be factually inaccurate and/or misleading. The paragraph on page 7-8 represents an unfair and inappropriate attack on an outstanding civil servant.

Joe Sherick
Joseph H. Sherick
Inspector General

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. [illegible]

OFFICE OF THE ASSISTANT SECRETARY

23 April 1985

MEMORANDUM FOR THE INSPECTOR GENERAL

SUBJECT: Testimony of Mr. A. Ernest Fitzgerald, 24 April 1985

I received the attached from Asst Secretary Carver's office last night. If you could be more specific in your criticism, I will change my draft statement to correct any alleged inaccuracies upon your presenting persuasive evidence that I am wrong.

A. E. Fitzgerald

A. E. FITZGERALD
Management Systems Deputy

Copy to:
Mr. Carver
Mr. Hershman

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. 20330

OFFICE OF THE SECRETARY

24 April 1985

RECEIVED
APR 24 1985
Subcommittee on
Oversight and Investigations

The Honorable John D. Dingell
United States House of
Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

There continues to be some misunderstanding as to the Air Force position regarding Mr. A. Ernest Fitzgerald's appearance before your Committee. Attached is a memorandum I sent to the Assistant Secretary of the Air Force, Mr. Richard Carver, Mr. Fitzgerald's immediate supervisor, outlining the principles we intend to follow regarding Mr. Fitzgerald's appearance before Congressional Committees.

We sincerely want to be responsive to your Committee needs and hope the attached information is useful to you in clarifying this issue.

E.C. Aldridge Jr

E. C. Aldridge, Jr.
Acting Secretary of the
Air Force

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. [illegible]

OFFICE OF THE UNDER SECRETARY

April 23, 1985

MEMORANDUM FOR MR. CARVER, SAF/FM

SUBJECT: Memorandum from Mr. A. Ernest Fitzgerald, 22 April 1985

The purpose of this memorandum is to respond to the question raised concerning Mr. Fitzgerald's desire to be instructed on the Air Force position relative to the issue raised by Congressman John Dingell, Chairman of the House Oversight and Investigations Subcommittee of the Energy and Commerce Committee in his recent letter. As you will note I have emphasized that this appears to be essentially a question of DOD perspective which would be more appropriately directed to the Secretary of Defense. Should Mr. Dingell direct his concern directly to me or Secretary Orr, I would be most willing to work with you and Mr. Fitzgerald to develop an appropriate response, otherwise the following principles should apply concerning these or other future hearings in which Mr. Fitzgerald may be requested to appear.

1. Mr. Fitzgerald is to appear before any committee of the House and Senate as requested in his official capacity as an Air Force employee and as Management Systems Deputy, Office of the Secretary of the Air Force.

2. Every effort will be made to clear Mr. Fitzgerald's testimony from the standpoint of security and policy. However, in the event that Mr. Fitzgerald's statement does not lend itself to clearance from an Air Force or DOD policy standpoint, e.g., it is a description of events in which he personally participated, it will be cleared for security purposes only. The statement will then be authorized for presentation if the cover sheet includes the caveat that the statement does not reflect the official position of the Department of the Air Force or the Department of Defense.

3. In no instance will the Air Force attempt to restrict Mr. Fitzgerald's appearance before Congress by delays in the clearance of his prepared statements. On the other hand, Mr. Fitzgerald shall give the Air Force adequate time to provide the appropriate clearances for his statements.

We must emphasize to the Congressional Committees that they should request information in such a way that, if desired, we can provide an official DOD or Air Force position. If this is done, we can work with Mr. Fitzgerald in a constructive way to present the desired information to Congress.

E. C. Aldridge, Jr.

E. C. Aldridge, Jr.

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. 20330

OFFICE OF THE ASSISTANT SECRETARY

24 April 1985

MEMORANDUM FOR MR. ALDRIDGE, SAFUS
THRU MR. CARVER, SAFFM

This responds to your memo to Mr. Carver (Atch 1) purportedly responding to the question I raised in my 22 April memo to you through Mr. Carver (Atch 2).

Again, most respectfully, your 23 April memo does not answer the question I raised, namely, what is the Air Force position on the matters in which Chairman Dingell is interested? With respect to the current situation, lack of time is a completely invalid excuse. The bulk of the information contained in my proposed statement to Chairman Dingell's Subcommittee started the review process in February 1984! The remainder is short enough that even the slowest readers among those officials with a legitimate interest or authority over my activities should have had plenty of time to read it since the afternoon of April 19.

I am completely dumbfounded by the following statement in your 23 April memo:

> "However, in the event that Mr. Fitzgerald's statement does not lend itself to clearance from an Air Force or DOD policy standpoint, e.g., it is a description of events in which he personally participated, then it will be cleared for security purposes only."

A plain English reading of this statement is that any events in which I personally participate cannot be fully cleared for open publication as I believe would be the case with any other employee of the Air Force. Does this mean that all my activities as Management Systems Deputy are unofficial? Given the Air Force management's consistent pattern of bad faith in dealing with me and my work, I suspect that you may have revealed the secret of the absolutely tragic failure to capture the opportunities for savings and other improvements that my associates and I have pinpointed.

Please tell me if any other Air Force employees fall under the "personal participation" policy you have ennunciated. If there are any, please give me their names.

A E Fitzgerald

A. E. FITZGERALD
Management Systems Deputy

Attachment

Copy to:
Mr. Harshman

TESTIMONY OF FRANK C. CONAHAN, DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY CLARK ADAMS, DIRECTOR, RESEARCH DEVELOPMENT, ACQUISITION, AND PROCUREMENT GROUP

Mr. CONAHAN. Thank you, Mr. Chairman. I will do precisely that.

Our testimony today focuses on some basic causes for questionable costs being allowed to contractor overhead, some examples of how such costs were allowed at a number of contractor activities and some suggestions for system improvements to prevent payment of unallowable costs.

The Government, through the Federal Acquisition Regulations, called the FAR, provides guidance on the allowability of contract costs. There are some overhead costs incurred by contractors which the Government deems to be unallowable under the FAR, and therefore not reimbursable under Government contracts.

DOD, through its Administrative Contracting Officers, called ACO's, routinely negotiates annual overhead agreements with contractors. These agreements determine what indirect costs are to be allowed for reimbursement in overhead.

To assist in these negotiations, ACO's seek advice from the Defense Contract Audit Agency. DCAA's reports evaluate the costs being claimed by the contractor and make recommendations to the contracting officer regarding the proprietary of such costs. Overhead negotiations are complex and differences concerning the allowability of certain costs are not easily resolved.

We believe that overhead negotiations could be improved if the FAR was less ambiguous in its definitions on the allowability of specific overhead costs. Ambiguities in the FAR cause contractors, DCAA and contracting officers to have different interpretations on allowability.

If a contractor believes a specific cost item is subject to interpretation, the contractor generally includes the cost in overhead. DCAA, in performing its overhead audits, uses the same FAR criteria, but often arrives at a different interpretation and, therefore, questions the costs.

If the contractor does not concede the questioned costs, they will be introduced into the negotiations between the contracting officer and the contractor. Perhaps a few illustrations from the FAR will make the point here.

One of the cost categories under FAR is advertising costs. That category is defined as follows:

Advertising includes conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising and radio and television programs.

Now the important part of this section is as follows:

The only advertising costs allowable are those that arise from requirements of Government contracts and that are for, one, recruiting personnel required for performing contractual obligations; two, acquiring scarce items for contract performance; or three, disposing of scrap or surplus materials required for contract performance.

Now there is another cost item in the FAR called selling costs, and I will quote one paragraph from it:

> Selling costs arise in the marketing of the contractor's products and include cost of sales promotions, negotiations, liaison between Government representatives and contractor's personnel and related activities.

Contractors frequently will use that selling cost provision to include what seems to be excludable and not allowable advertising costs. That is one example of ambiguity that exists in the Federal Acquisition Regulations.

Just another short one. Subsection 31.205-14 of the FAR is entertainment costs, this says:

> Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-13 and 31.205-43).

Two other sections of the FAR.

Let me go to 31.205-13 and it's entitled "Employee Morale, Health, Welfare, Food Service and Dormitory Costs and Credits." And these costs are allowable under the FAR.

Contractors oftentimes will put costs into the contract under that provision which some folks would think should be excluded under the advertising provision. As bad as that is, there is one that is much more difficult to handle, and that is 31.205-43.

Mr. WYDEN. Mr. Conahan, we would like to make subpart 31.2 a part of the record following your testimony.

Mr. CONAHAN. Subsection 31.205-43, trade, business, technical, and professional activity costs, says: "The following types of costs are allowable," and it goes A, B, and let me quote C:

> Meetings and conferences, including meals, transportation, rental of meeting facilities, and other incidental costs when the primary purpose of the incurrence of the costs is the dissemination of technical information or stimulation of production.

Here again, you have got a wide avenue where costs which are unallowable under entertainment can be argued to be allowable under this other category of costs, and frequently are.

In 1984, we reported in our review of ACO final overhead cost settlements in 12 contractor activities. These activities were General Dynamics headquarters, General Dynamics Fort Worth, Hercules Aerospace Division, Hughes Aircraft Co., LTV, McDonnell-Douglas Corp., Martin-Marietta Aerospace Denver Division, Raytheon Co., Saunders Associates, Texas Instruments, Thiokol-Wasatch Division, and United Technologies Corp.

We noted that there were numerous instances where DCAA was challenging, as unallowable expenses, significant amounts of contractor costs that the ACO's were overruling DCAA and allowing a significant percentage of the costs questioned by DCAA.

We also observed that the ACO, in the interest of expediency, was not preparing adequate documentation regarding the disposition of costs questioned by DCAA. We believe in that regard that they certainly should do so.

Additionally, there was a reluctance on the part of contractors and ACO's to negotiate and agree to items of costs questioned by audit on an item-by-item basis or an element-by-element basis.

This reluctance stems from the knowledge that once an item of cost, such as institutional advertising, has been mutually agreed to as being unallowable, Cost Accounting Standard 405 would require that henceforth such costs would have to be excluded from any billing, claim or proposal applicable to a Government contract.

It is this reluctance and the acquiescence to this procedure by contracting officers which produces the bottom line negotiations which we found prevalent. By agreeing to the compromise figure in total, without addressing any specific cost element, the contractor can continue year after year to keep these costs in the overhead proposal for bottom line negotiations. Moreover, since these negotiations are on a total basis, a 50-50 split is generally the rule rather than the exception.

For example, of the 12 contracting activities we reviewed, $31 million of costs challenged by DCAA as unallowable were introduced into negotiations. In the ensuing negotiations the contracting officers allowed into overhead $16.5 million, or 53 percent.

Let me cite some examples of costs questioned by DCAA and the disposition of these costs by ACO's during negotiations.

Of $574,000 in advertising costs questioned by DCAA at Hughes, Raytheon, and United Technologies, contracting officers allowed approximately $218,000 and sustained $356,000 of DCAA's questioned costs.

For example, at Hughes, the contracting officer allowed $202,000 of $532,400 questioned by DCAA. These costs were for advertisements in magazines, such as Newsweek and Time. The full page ads in the magazines contained extensive descriptions of the company's products, with approximately 15 percent of the ads devoted to employee recruitment.

The contracting officer felt that the recruitment portion of the advertisement should be allowed and thus reinstated the cost.

[Testimony resumes on p. 346.]

[The prepared statement and attachment of Mr. Conahan follow:]

STATEMENT OF

FRANK C. CONAHAN, DIRECTOR

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

UNITED STATES GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee to discuss the Department of Defense's (DOD's) system to prevent payment of defense contractors' unallowable overhead costs. Overhead or indirect costs at contractors' operations represent a significant amount of costs reimbursed to contractors under government contracts. On average, overhead represents almost 66 percent of total in-plant costs. Indirect costs are any costs not directly identified with a particular contract.

THE OVERHEAD COST PROBLEM

There are some overhead costs incurred by contractors which the government deems to be unallowable and, therefore, not reimbursable under government contracts. Unallowable costs are those that under the provisions of any pertinent law, regulation, or contract cannot be included in prices, cost reimbursements, or settlements under a government contract. The government, through the Federal Acquisition Regulation (FAR), provides guidance on the allowability of contract costs.

DOD through its Administrative Contracting Officers (ACOs) routinely negotiates annual overhead agreements with contractors. These agreements determine what indirect costs are to be allowable for reimbursement in overhead. The contracting officer has the responsibility to negotiate the overhead agreement with the contractors. In discharging this responsibility the ACO seeks advice from the Defense Contract Audit Agency (DCAA).

This agency has the responsibility to audit the books and records of defense contractors and make recommendations to the ACOs regarding the audited costs. DCAA's reports evaluate the costs being claimed by the contractor and make recommendations to the contracting officer regarding the propriety of such costs. DCAA's audit reports are used to assist in these negotiations.

Overhead negotiations between the government and the contractors are complex and differences concerning the allowability of certain costs are not easily resolved. The negotiations are based on the allowability criteria established in the FAR. We believe that overhead negotiations could be improved if FAR was less ambiguous in its definitions on the allowability of specific overhead costs.

Ambiguities in FAR cause contractors, DCAA, and contracting officers to have different interpretations on allowability. If a contractor believes a specific cost item is subject to interpretation, the contractor generally includes the cost in overhead. DCAA, in performing its overhead audits, uses the same FAR criteria but often arrives at a different interpretation and, therefore, questions the costs. If the contractor does not concede the questioned costs, they will be introduced into negotiations between the contracting officer and the contractor.

In ~~1980~~ 1970 the Congress established the Cost Accounting Standards Board. In the 10 years of its existence, this Board issued 19 cost accounting standards which are designed to improve the process of accounting for costs on government contracts. One of those Cost Accounting Standards is CAS 405, "Accounting for Unallowable Costs." CAS 405 was promulgated to facilitate the negotiation, audit, administration, and settlement of contracts by establishing guidelines covering: (1) the identification of costs specifically described in the FAR as unallowable and (2) the accounting treatment to be accorded such costs. According to the Standard, costs expressly unallowable or mutually agreed to be unallowable are to be identified and excluded from any billing, claim, or proposal applicable to a government contract.

In 1984, we reported on our review of ACO final overhead cost settlements at 12 contracting activities.[1] These activities were General Dynamics headquarters, General Dynamics-Fort Worth, Hercules Aerospace Division, Hughes Aircraft Company, LTV, McDonnell-Douglas Corporation, Martin Marietta Aerospace-Denver Division, Raytheon Company, Sanders Associates, Texas Instruments, Thiokol-Wasatch Division, and United Technologies Corporation. Our work disclosed that noncompliance with CAS 405 did not appear to be a problem. We noted, however, that there were numerous instances where DCAA was challenging, as unallowable expenses, significant amounts of contractor costs, but the ACOs were overruling DCAA and allowing a significant percentage of the costs questioned by DCAA. We also observed that the ACO, in the interest of expediency, was not preparing adequate documentation regarding the disposition of the costs questioned by DCAA.

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[1] Testimony before the Subcommittee on Legislation and National Security, House Committe on Government Operations, July 25, 1984.

Report to the Secretary of Defense (GAO/NSIAD-85-20), October 29, 1984.

Additionally, there is a reluctance on the part of contractors and ACOs to negotiate and agree to items of cost questioned by audit reports on an item-by-item basis. This reluctance apparently stems from the knowledge that once an item of cost, such as institutional advertising, had been mutually agreed to as being unallowable, CAS 405 would require that, thenceforth, such costs would have to be excluded from any billing, claim, or proposal applicable to a government contract.

It is the reluctance to identify and mutually agree to specific cost elements on the part of the contractors and the acquiescence to this procedure by contracting officers which produces the "bottom line" negotiations which we found prevalent. By agreeing to the compromise figure in total, without addressing any specific cost element such as airshows, models, or giveaways, the contractor can continue, year after year, to keep these cost in the overhead proposal for "bottom line" negotiations. I believe more aggressive pursuit by contracting officers in identifying and documenting individual elements of cost in overhead settlements as unallowable will contribute to the effectiveness of CAS 405 and will be a major step in helping DOD's system of preventing reimbursement of unallowable costs on government contracts.

DCAA OVERHEAD AUDITS AND ACO NEGOTIATIONS

DCAA's system for planning its overhead audits is generally adequate. There is, however, some room for improving the quality of the audits. For example, our review disclosed some instances where DCAA could have used better audit techniques or obtained and presented more substantive documentation for its findings.

DCAA auditors told us that they often could not find the contractors to be in non-compliance with CAS 405 because the procurement regulations are not specific enough as to what costs are unallowable.

The rules as to what costs will be allowable for reimbursement against government contracts are set forth in the FAR (formerly Defense Acquisition Regulations (DAR)). These rules are extensive and complex. Differing interpretations cause a wide divergence of views regarding what is and what is not allowable.

The contracting officer, as the final authority at the contract level, must weigh these differing opinions and decide. This decision is usually made through a negotiation process. And, as mentioned above, negotiations are usually done on a total basis without specific agreement on individual elements of cost. Since these negotiations are on a total basis, a 50/50 split is generally the rule rather than the exception. For example, at the 12 contracting activities we reviewed, $31 million of costs challenged by DCAA as unallowable were introduced into negotiations. In the ensuing negotiations, the contracting officers allowed into overhead $16.5 million or 53 percent.

EXAMPLES OF QUESTIONED COSTS

Following are some examples of costs questioned by DCAA and the disposition of these costs by ACOs during negotiations.

Air shows

We found that DCAA questioned $1.04 million in costs incurred by six of the contractors for the Paris Air Show, the Farnborough Air Show, and similar events on the basis that these costs were unallowable advertising. These contractors were General Dynamics headquarters, GD-Fort Worth, Martin Marietta, McDonnell-Douglas, Raytheon, and UTC. Contractors believe these costs are allowable under the FAR's definitions for "Selling Costs" and "Trade, Business, Technical, and Professional Activity Costs." The contracting officers took widely disparate views in settling these costs, ranging from total allowance to total disallowance. For example, the contracting officer at GD-headquarters allowed into overhead 100 percent of the $28,000 questioned by DCAA for exhibits at the Paris Air Show.

At Raytheon the contracting officer disallowed 100 percent of the $388,000 incurred for constructing, operating, and dismantling a chalet at the Paris Air Show because these costs were held to be unallowable advertising and entertainment. At Raytheon also the contracting officer allowed 100 percent of the $35,000 questioned by DCAA for trips made by high level contractor marketing and public relations personnel to the Paris Air Show. The contracting officer considered these costs to be allowable selling and public relations functions.

Advertising

Of $574,000 in advertising costs questioned by DCAA at Hughes, Raytheon, and UTC contracting officers allowed approximately $218,000 and sustained $356,000 of DCAA's questioned costs.

For example, at Hughes the contracting officer allowed $202,000 of $532,400 questioned by DCAA. These costs were for advertisements in magazines such as Newsweek and Time. The full page ads in the magazines contained extensive descriptions of the company's products with approximately 15 percent of the ads devoted to employee recruitment. The contracting officer felt that the recruiting portion of the advertisement should be allowed and thus reinstated the costs.

At UTC the contracting officer allowed $15,000, or 44 percent of the $34,244 questioned by DCAA as unallowable advertising. This amount was apparently allowed because it represented costs incurred in producing a technical public relations film.

Exhibits, displays, promotions, and giveaways

DCAA questioned approximately $2.33 million incurred by six contracting activities (GD-headquarters, GD-Ft. Worth, McDonnell-Douglas, Martin Marietta, Thiokol, and UTC) for exhibits, displays, promotions, models, and giveaways on the grounds these were unallowable advertising costs. Notwithstanding DCAA's recommendations, contracting officers allowed into overhead $1.04 million, or 45 percent of the amount questioned.

For example, we reviewed GD-Fort Worth's cost data amounting to about $358,000 associated with aircraft models and other give away items. The contractor stated that these were allowable costs to promote the sale of a company product as defined under the FAR provision on Selling Costs. The contractor argued that the costs were allowable public relations marketing expenses because the contractor kept a list of the recipients of the models and giveaways. For these reasons, the contracting officer allowed about $250,000, or 70 percent of these costs to be charged to the government.

Another contractor, Martin Marietta claimed technical display costs of $33,000 for brochures, prints, models, and mock-ups as allowable public relations costs. According to the contractor, the models were displayed and brochures distributed at the Paris Air Show and other shows, as well as in local banks and other public places. The contracting officer allowed $18,000 because these costs were considered to be "gray area" expenditures.

Consultants

Of $945,000 in consulting expenses questioned by DCAA at six contracting activities (LTV, McDonnell Douglas, Hughes, Raytheon, Sanders, and UTC), ACOs allowed approximately $271,000 and sustained $674,000 of DCAA's questioned costs. For example, at LTV DCAA questioned $57,000 which was paid to two consultants. DCAA argued that payments to the first consultant, a former company employee were not allowable because he did not provide services to the corporation. Expenses paid to the second consultant were questioned because the consultant was a Public Relations firm which arranged a meeting for customers of LTV's subsidiary, a food company. In DCAA's opinion, this meeting had nothing to do with government contracts.

In settling these costs the ACO split the amount 50/50 based on prior years' settlements. According to the ACO, the amount conceded has an immaterial effect on the final overhead rate.

At Raytheon, DCAA questioned $87,000 on the basis that, "the contractor still does not provide specific details as to what projects or areas these people consult on." The ACO reinstated the full amount on the basis that the fees were reasonable and because the contractor agreed that future consulting agreements would contain the nature of services rendered.

Entertainment

DCAA questioned approximately $108,000 incurred by four contracting activities (Hughes, GD-Ft. Worth, Martin Marietta, and Raytheon) for entertainment on the basis these were social entertainment. The ACOs allowed into overhead $61,000 or 57% of the amounts questioned.

At Martin Marietta DCAA questioned $45,000 in petty cash transactions as unallowable entertainment. These costs included off-site business meetings where the primary purpose appeared to be attendance at a retirement party; personal expenses; golf course fees; and meetings, parties, gatherings, and dinners where supporting documentation showed these functions to be primarily for entertainment. For example, DCAA questioned the allowability of $7,704 incurred by the contractor at the Cherry Hills Country Club in Denver and the Lakewood Country Club in New Orleans and at other off-site business meetings combined with golf at Vail, Colorado. The contractor conceded $509 for "unallowable items inadvertently claimed." The contractor maintained the other costs were allowable off-site business meeting costs and stated "meetings must be held off-site in an interruption free environment which is conducive to the business discussions at hand."

According to ACO personnel, these entertainment costs are in a "grey area" since they could be partial legitimate business expenses. Only $10,000 of the $45,000 challenged by DCAA were disallowed.

At GD-Fort Worth, DCAA questioned $3,018 which was incurred for an Air National Guard and Thunderbird Reunion. The ACO disallowed only $18.

Travel

Of $919,000 challenged by DCAA at seven contracting activities (GD-headquarters, Hughes, LTV, McDonnell Douglas, Martin Marietta, Raytheon, and Thiokol), the ACOs allowed approximately $599,000 and sustained $319,000 of DCAA's questioned costs. At Raytheon, for example, DCAA questioned $181,000 which included such items as first class travel and the costs of hotel rooms, meals, and plane fares for spouses of contractor employees on travel. The ACOs allowed $125,000 or 69% of DCAA's questioned costs.

DOCUMENTATION OF NEGOTIATIONS IS INADEQUATE

Preparation of documentation, which establishes the basis for prenegotiation positions and fully explains the rationale for final disposition of DCAA's recommendations, is essential to the overview and control of the negotiation process. The FAR requires the contracting officer to prepare a negotiation memorandum, which addresses the disposition of significant matters in the DCAA audit report and resolution of questioned costs.

At the 12 contractor segments we visited, the ACOs did not adequately document prenegotiation positions. Although they generally prepared a memorandum of negotiated results, they did not always fully explain the basis for negotiated cost determinations. For example, at a Navy contractor activity, we could find no documentation of the rationale for negotiated agreements. Navy officials could not explain why documentation was not prepared.

At an Air Force contractor activity, we found no documentation of prenegotiation positions for a recently completed negotiated settlement. The government negotiator could not explain how some of the cost settlements were derived. After our discussions with the negotiator, a memorandum of negotiation was prepared using data from DCAA and other sources.

IMPROVING THE SYSTEM

We believe that the system which DOD now employs to prevent reimbursement of unallowable costs on government contracts should be improved in two ways.

First, the appropriate sections of FAR should be clarified in such a way as to eliminate present ambiguities that are allowing such a wide divergence of opinions among DCAA, the contractors, and the ACOs. We recognize that the criteria for all cost elements cannot be written in such a way as to remove all ambiguity and that there undoubtedly will remain differences and disagreements as to the allowability of certain costs. We believe, however, that there are opportunities to clarify the criteria for some of the cost elements so as to reduce these differences and disagreements and, last year, we made certain recommendations to the Secretary of Defense in that regard.

We are pleased to note that a proposed change to FAR is now being circulated for comment. This gives specific definition to public relations and advertising costs and specifically addresses circumstances under which these types of costs are allowable or unallowable. The change in this category of costs is a positive step and should eliminate much of the confusion concerning these costs. We believe, however, that the change should go further and we plan to make recommendations to the Secretary of Defense to accomplish this.

A second improvement to the current system would be the requirement for ACOs to negotiate and settle the costs questioned as unallowable by DCAA on overhead claims on an element-by-element basis. Currently, the FAR requires that the cognizant contracting officer prepare and place in the general file a negotiation memorandum which explains the rationale for the overhead settlement reached with the contractor. As individual cost elements are mutually agreed to by the government and contractor, those costs would be eliminated from future billings and the perennial negotiations concerning those costs would be eliminated.

We recognize that contractors will continue to be reluctant to negotiate and settle elements of cost on an item-by-item basis. Moreover, all government officials associated with the procurement process, not just the ACO, will have to have the resolve to accomplish this.

Mr. Chairman, this concludes my prepared statement and I will be pleased to answer any questions you or members of the Subcommittee may have.

SUBPART 31.2—CONTRACTS WITH COMMERCIAL ORGANIZATIONS

31.201 General.

31.201-1 Composition of total cost.

The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money pursuant to 31.205-10. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used, including standard costs properly adjusted for applicable variances. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.

31.201-2 Determining allowability.

(a) The factors to be considered in determining whether a cost is allowable include the following:

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting

principles and practices appropriate to the particular circumstances.

(4) Terms of the contract.

(5) Any limitations set forth in this subpart.

(b) Certain cost principles in this subpart incorporate the measurement, assignment, and allocability rules of selected CAS and limit the allowability of costs to the amounts determined using the criteria in those selected standards. Only those CAS or portions of standards specifically made applicable by the cost principles in this subpart are mandatory unless the contract is CAS-covered (see Part 30). Business units that are not otherwise subject to these standards under a CAS clause are subject to the selected standards only for the purpose of determining allowability of costs on Government contracts. Including the selected standards in the cost principles does not subject the business unit to any other CAS rules and regulations. The applicability of the CAS rules and regulations is determined by the CAS clause, if any, in the contract and the requirements of the standards themselves.

(c) When contractor accounting practices are inconsistent with this Subpart 31.2, costs resulting from such inconsistent practices shall not be allowed in excess of the amount that would have resulted from using practices consistent with this subpart.

31.201-3 Determining reasonableness.

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a specific cost, the contracting officer shall consider—

(a) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;

(b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's-length bargaining, Federal and State laws and regulations, and contract terms and specifications;

(c) The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government, and the public at large, would take under the circumstances; and

(d) Any significant deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

31.201-4 Determining allocability.

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

31.201-5 Credits.

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

31.201-6 Accounting for unallowable costs.

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

(b) Costs which specifically become designated as unallowable or as unallowable directly associated costs of unallowable costs as a result of a written decision furnished by a contracting officer shall be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this paragraph or paragraph (a) above.

(c) The detail and depth of records required as backup support for proposals, billings, or claims shall be that which is adequate to establish and maintain visibility of identified unallowable costs, including directly associated costs. Unallowable costs involved in determining rates used for standard costs, or for indirect cost proposals or billing, need be identified only at the time rates are proposed, established, revised, or adjusted. These requirements may be satisfied by any form of cost identification which is adequate for purposes of contract cost determination and verification.

(d) If a directly associated cost is included in a cost pool which is allocated over a base that includes the unallowable cost with which it is associated, the directly associated cost shall remain in the cost pool. Since the unallowable costs will attract their allocable share of costs from the cost pool, no further action is required to assure disallowance of the directly associated costs. In all other cases, the directly associated costs, if material in amount, must be purged from the cost pool as unallowable costs.

(e) (1) In determining the materiality of a directly associated cost, consideration should be given to the significance of (i) the actual dollar amount, (ii) the cumulative effect of all directly associated costs in a cost pool, or (iii) the ultimate effect on the cost of Government contracts.

(2) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with subparagraph (e)(1) above (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities should be compared to total time spent on company activities to determine if the costs are material. Time spent by employees outside the normal working hours should not be considered except when it is evident that an employee engages so frequently in company activities during periods outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(3) When a selected item of cost under 31.205 provides that directly associated costs be unallowable, it is intended that such directly associated costs be unallowable only if determined to be material in amount in accordance with the criteria provided in subparagraphs (e)(1) and (e)(2) above, except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

31.201-7 Construction and architect-engineer contracts.

Specific principles and procedures for evaluating and determining costs in connection with contracts and subcontracts for construction, and architect-engineer contracts related to construction projects, are in 31.105. The applicability of these principles and procedures is set forth in 31.000 and 31.102.

31.202 Direct costs.

(a) A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

(b) For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment—

(1) Is consistently applied to all final cost objectives; and

(2) Produces substantially the same results as treating the cost as a direct cost.

31.203 Indirect costs.

(a) An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost. After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to the several cost objectives. An indirect cost shall not be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

(b) Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. Similarly, the particular case may require subdivision of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. This necessitates selecting a distribution base common to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

(c) Once an appropriate base for distributing indirect costs has been accepted, it shall not be fragmented by removing individual elements. All items properly includable in an indirect cost base should bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs. For example, when a cost input base is used for the distribution of G&A costs, all items that would properly be part of the cost input base, whether allowable or unallowable, shall be included in the base and bear their pro rata share of G&A costs.

(d) The contractor's method of allocating indirect costs shall be in accordance with standards promulgated by the CAS Board, if applicable to the contract; otherwise, the method shall be in accordance with generally accepted accounting principles which are consistently applied. The method may require examination when—

(1) Substantial differences occur between the cost patterns of work under the contract and the contractor's other work;

(2) Significant changes occur in the nature of the business, the extent of subcontracting, fixed-asset improvement programs, inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances; or

(3) Indirect cost groupings developed for a contractor's primary location are applied to offsite locations. Separate cost groupings for costs allocable to offsite locations may be necessary to permit equitable distribution of costs on the basis of the benefits accruing to the several cost objectives.

(e) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for distribution to work performed in that period. The criteria and guidance in CAS 406 for selecting the cost accounting periods to be used in allocating indirect costs are incorporated herein for application to contracts subject to full CAS coverage. For contracts subject to modified CAS coverage and for non-CAS-covered contracts, the base period for allocating indirect costs will normally be the contractor's fiscal year. But a shorter period may be appropriate (1) for contracts in which performance involves only a minor portion of the fiscal year or (2) when it is general practice in the industry to use a shorter period. When a contract is performed over an extended period, as many base periods shall be used as are required to represent the period of contract performance.

(f) Special care should be exercised in applying the principles of paragraphs (b), (c), and (d) above when Government-owned contractor-operated (GOCO) plants are involved. The distribution of corporate, division, or branch office G&A expenses to such plants operating with little or no dependence on corporate administrative activities may require more precise cost groupings, detailed accounts screening, and carefully developed distribution bases.

31.204 Application of principles and procedures.

(a) Costs shall be allowed to the extent they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205. These criteria apply to all of the selected items that follow, even if particular guidance is provided for certain items for emphasis or clarity.

(b) Costs incurred as reimbursements or payments to a subcontractor under a cost-reimbursement, fixed-price incentive, or price redeterminable type subcontract of any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions are allowable to the extent that allowance is consistent with the appropriate subpart of this Part 31 applicable to the subcontract involved. Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, when cost analysis was performed under 15.805-3, shall be allowable only to the extent that the price was negotiated in accordance with 31.102.

(c) Section 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items.

31.205 Selected costs.

31.205-1 Advertising costs.

(a) "Advertising costs" means the costs of advertising and directly associated costs, regardless of the medium employed, when the advertiser has control over the form and content of what will appear, the media in which it will appear, and when it will appear. Advertising media includes conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising, and radio and television programs.

(b) The only advertising costs allowable are those that arise from requirements of Government contracts and that are for—

(1) Recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34);

(2) Acquiring scarce items for contract performance; or

(3) Disposing of scrap or surplus materials acquired for contract performance.

Costs of this nature, if incurred for more than one defense contract or both defense work and other work of the contractor, are allowable to the extent that the principles in 31.201-3, 31.201-4, and 31.203 are observed.

(c) Advertising costs other than those specified in paragraph (b) above are unallowable. Unallowable advertising costs include those related to sales promotion which involve direct payment for using time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing the overall company image to sell the company's products.

31.205-2 Automatic data processing equipment leasing costs.

(a) This subsection applies to all contractor-leased automatic data processing equipment (ADPE), as defined in 31.001 (except as components of an end item to be delivered to the Government), acquired under operating leases, as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board. Compliance with 31.205-11(m) requires that

ADPE acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges or over the leased life as amortization charges as appropriate. Allowability of costs related to contractor-owned ADPE is governed by other requirements of this subpart.

(b) (1) If the contractor leases ADPE but cannot demonstrate, on the basis of facts existent at the time of the decision to lease or continue leasing and documented in accordance with paragraph (d) below, that leasing will result in less cost to the Government over the anticipated useful life (see paragraph (c) below), then rental costs are allowable only up to the amount that would be allowed had the contractor purchased the ADPE.

(2) The costs of leasing ADPE are allowable only to the extent that the contractor can annually demonstrate in accordance with paragraph (*d*) below (whether or not the term of lease is renewed or otherwise extended) that these costs meet the following criteria:

(i) The costs are reasonable and necessary for the conduct of the contractor's business in light of factors such as the contractor's requirements for ADPE, costs of comparable facilities, the various types of leases available, and the terms of the rental agreement.

(ii) The costs do not give rise to a material equity in the facilities (such as an option to renew or purchase at a bargain rental or price other than that normally *given* to industry *at* large) but represent charges only for the current use of the equipment, including incidental service costs such as maintenance, insurance, and applicable taxes.

(iii) The contracting officer's approval was obtained for the leasing arrangement (see subparagraph (d)(3) below) when the total cost of leasing—

(A) The ADPE is to be allocated to one or more Government contracts which require negotiating or determining costs, or

(B) ADPE in a single plant, division, or cost center exceeds $500,000 a year and 50 percent or more of the total leasing cost is to be allocated to one or more Government contracts which require negotiating or determining costs.

(3) Rental costs under a sale and leaseback arrangement are allowable only up to the amount that would have been allowed had the contractor retained title to the ADPE.

(4) Allowable rental costs of ADPE leased from any division, subsidiary, or organization under a common control are limited to the cost of ownership (excluding interest or other costs unallowable under this Subpart 31.2 and including the cost of money (see 31.205-10)). When there is an established practice of leasing the same or similar equipment to unaffiliated lessees, rental costs shall be allowed in accordance with subparagraphs (b)(1) and (2) above, except that the purchase price and costs of ownership shall be determined under 31.205-26(e).

(c) (1) An estimate of the anticipated useful life of the ADPE may represent the application life (utility in a given function), technological life (utility before becoming obsolete in whole or in part), or physical life (utility before wearing out) depending upon the facts and circumstances and the particular facilities involved. Each case must be evaluated individually. In estimating anticipated useful life, the contractor may use the application life if it can be demonstrated that the ADPE has utility only in a given function and the duration of the function can be determined. Technological life may be used if the contractor can demonstrate that existing ADPE must be replaced because of—

(i) Specific program objectives or contract requirements that cannot be accomplished with the existing ADPE;

(ii) Cost reductions that will produce identifiable savings in production or overhead costs;

(iii) Increase in workload volume that cannot be accomplished efficiently by modifying or augmenting existing ADPE; or

(iv) Consistent pattern of capacity operation (2 ½-3 shifts) on existing ADPE.

(2) Technological advances will not justify replacing existing ADPE before the end of its physical life if it will be able to satisfy future requirements or demands.

(3) In estimating the least cost to the Government for useful life, the cumulative costs that would be allowed if the contractor owned the ADPE should be compared with cumulative costs that would be allowed under any of the various types of leasing arrangements available. For the purpose of this comparison, the costs of ADPE exclude interest or other unallowable costs pursuant to this Subpart 31.2; they include but are not limited to the costs of operation, maintenance, insurance, depreciation, facilities capital cost of money, rental, and the cost of machine services, as applicable.

(d) (1) Except as provided in subparagraph (3) below, the contractor's justification, under paragraph (b) above, of the leasing decisions shall consist of the following supporting data, prepared before acquisition:

(i) Analysis of use of existing ADPE.

(ii) Application of the criteria in paragraph (b) above.

(iii) Specific objectives or requirements, generally in the form of a data system study and specification.

(iv) Solicitation of proposals, based on the data system specification, from qualified sources.

(v) Proposals received in response to the solicitation and reasons for selecting the equipment chosen and for the decision to lease.

(2) Except as provided in subparagraph (3) below, the contractor's annual justification, under subparagraph (b)(2) above, of the decision to retain or change existing ADPE capability and the need to continue leasing shall consist of current data as specified in subdivisions (d)(1)(i) through (iii) above.

(3) If the contractor's prospective ADPE lease cost meets the threshold in 31.205-2(b)(2)(iii) above, the contractor shall furnish data supporting the initial decision to lease (see subparagraph (b)(1) above). If the total cost of leasing ADPE in a single plant, division, or cost center exceeds $500,000 per year and 50 percent or more of the total leasing cost is allocated to Government contracts which require negotiating or determining costs, the contractor shall furnish data supporting the annual justification for retaining or changing existing ADPE capability and the need to continue leasing shall also be furnished (see subparagraph (b)(2) above).

31.205-3 Bad debts.

Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs, and legal costs are unallowable.

31.205-4 Bonding costs.

(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. They arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the contract are allowable.

(c) Costs of bonding required by the contractor in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

31.205-5 Civil defense costs.

(a) Civil defense costs are those incurred in planning for, and protecting life and property against, the possible effects of enemy attack. Costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire fighting training and equipment, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the contractor's premises pursuant to suggestions or requirements of civil defense authorities are allowable when allocated to all work of the contractor.

(b) Costs of capital assets acquired for civil defense purposes are allowable through depreciation (see 31.205-11).

(c) Contributions to local civil defense funds and projects are unallowable.

31.205-6 Compensation for personal services.

(a) *General.* Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance (except as otherwise provided for severance pay costs in paragraph (g) below and for pension costs in paragraph (j) below). It includes, but is not limited to, salaries; wages; directors' and executive committee members' fees; bonuses (including stock bonuses); incentive awards; employee stock options, stock appreciation rights, and stock ownership plans; employee insurance; fringe benefits; contributions to pension, annuity, and management employee incentive compensation plans; and allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost of living differential. Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages (but see 31.205-6(g), (h), (j), (k), and (m) below).

(2) The compensation in total must be reasonable for the work performed; however, specific restrictions on individual compensation elements must be observed where they are prescribed.

(3) The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor—

(i) Has not notified the cognizant ACO of the changes either before their implementation or within a reasonable period after their implementation, and

(ii) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 shall not be allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services. (See 31.205-34(c).)

(b) *Reasonableness*. Compensation for personal services will be considered reasonable if the total compensation conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area for similar services or work performed. This does not preclude the Government from challenging the reasonableness of an individual element of compensation where costs are excessive in comparison with compensation paid by other firms of the same size, same industry, or in the same geographic area for similar services. In administering this principle, it is recognized that not every compensation case need be subjected in detail to the above tests. The tests need be applied only when a general review reveals amounts or types of compensation that appear unreasonable or unjustified. In questionable cases, the contractor has responsibility to support the reasonableness of the compensation in relation to the effort performed. Compensation costs under certain conditions give rise to the need for special consideration. Among such conditions are the following:

(1) Compensation to (i) owners of closely held corporations, partners, sole proprietors, or members of their immediate families, or (ii) persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise. Determination should be made that salaries are reasonable for the personal services rendered rather than being a distribution of profits. Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits. For closely held corporations, compensation costs covered by this subparagraph shall not be recognized in amounts exceeding those costs that are deductible as compensation under the Internal Revenue Code and regulations under it.

(2) Any change in a contractor's compensation policy that results in a substantial increase in the contractor's level of compensation, particularly when it was concurrent with an increase in the ratio of Government contracts to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy. No presumption of reasonableness will exist where major revisions of existing compensation plans or new plans are introduced by the contractor; and the contractor—

(i) Has not notified the cognizant ACO of the change either before their implementation or within a reasonable period after their implementation; and

(ii) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the reasonableness of the changes.

(3) The contractor's business is such that its compensation levels are not subject to the restraints that normally occur in the conduct of competitive business.

(4) The contractor incurs costs for compensation in excess of the amounts which are deductible under the Internal Revenue Code and regulations issued under it.

(c) *Labor-management agreements*. Nothwithstanding any other requirements of this subsection 31.205-6, costs of compensation are not allowable to the extent that they result from provisions of labor-management agreements that, as applied to work in performing Government contracts, are determined to be unreasonable because they are either unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (e.g., work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (e.g., work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances. Disallowance of costs will not be made under this paragraph (c) unless—

(1) The contractor has been permitted an opportunity to justify the costs; and

(2) Due consideration has been given to whether unusual conditions pertain to Government contract work, imposing burdens, hardships, or hazards on the contractor's employees, for which compensation that might otherwise appear unreasonable is required to attract and hold necessary personnel.

(d) *Salaries and wages*. Salaries and wages for current services include gross compensation paid to employees in the form of cash, stock (see subparagraph (f)(2) below regarding valuation), products, or services, and are allowable.

(e) *Domestic and foreign differential pay*. (1) When personal services are performed in a foreign country, compensation may also include a differential that may properly consider all expenses associated with foreign employment such as housing, cost of living adjustments, transportation, bonuses, additional Federal, State, local or foreign income taxes resulting from foreign assignment, and other related expenses.

(2) Although the additional taxes in subparagraph (1) above may be considered in establishing foreign overseas differential, any increased compensation calculated directly on the basis of an employee's specific increase in income taxes is unallowable. Differential allowances for additional Federal, State, or local

income taxes resulting from domestic assignments are unallowable.

(f) *Bonuses and incentive compensation.* (1) Incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance are allowable provided the awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment and the basis for the award is supported.

(2) When the costs of bonuses and incentive compensation are paid in the stock of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the stock shall be the fair market value on the measurement date (i.e., the first date the number of shares awarded is known) determined upon the most objective basis available; and

(ii) Accruals for the cost of stock before issuing the stock to the employees shall be subject to adjustment according to the possibilities that the employees will not receive the stock and that their interest in the accruals will be forfeited.

(3) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of subparagraph (f)(1) above and of paragraph (k) below.

(g) *Severance pay.* (1) Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in subparagraph (j)(6) below.

(2) Severance pay to be allowable must meet the general allowability criteria in subdivision (g)(2)(i) below, and, depending upon whether the severance is normal or abnormal, criteria in subdivision (g)(2)(ii) for normal severance pay or subdivision (g)(2)(iii) for abnormal severance pay also apply.

(i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law, (B) employer-employee agreement, (C) established policy that constitutes, in effect, an implied agreement on the contractor's part, or (D) circumstances of the particular employment. Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable. Severance payments, or amounts paid in lieu thereof, are not allowable when paid to employees in addition to early or normal retirement payments.

(ii) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant, or where the contractor provides for accrual of pay for normal severances, that method will be acceptable if the amount of the accrual is reasonable in light of payments actually made for normal severances over a representative past period and if amounts accrued are allocated to all work performed in the contractor's plant.

(iii) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis.

(h) *Backpay.* (1) *Backpay resulting from violations of Federal labor laws or the Civil Rights Act of 1964.* Backpay may result from a negotiated settlement, order, or court decree that resolves a violation of Federal labor laws or the Civil Rights Act of 1964. Such backpay falls into two categories: one requiring the contractor to pay employees additional compensation for work performed for which they were underpaid, and the other resulting from other violations, such as when the employee was improperly discharged, discriminated against, or other circumstances for which the backpay was not additional compensation for work performed. Backpay resulting from underpaid work is compensation for the work performed and is allowable. All other backpay resulting from violation of Federal labor laws or the Civil Rights Act of 1964 is unallowable.

(2) *Other backpay.* Backpay may also result from payments to union employees (union and non-union) for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiations. Such backpay is allowable. Backpay to nonunion employees based upon results of union agreement negotiations is allowable only if (i) a formal agreement or understanding exists between management and the employees concerning these payments, or (ii) an established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payment.

(i) *Stock options, stock appreciation rights, and phantom stock plans.* (1) The cost of stock options awarded to employees to purchase stock of the contractor or of an affiliate will be treated as deferred compensation and must comply with the requirements of paragraph (k) below and with the allowability criteria contained in subparagraph (i)(2) below. The allowable cost of stock appreciation rights, whether offered separately or combined with stock options, will be determined in the same manner as stock options.

(2) The allowable costs of stock options and stock appreciation rights will be limited to the difference between the option price or stock-appreciation-right price and the market price of the stock on the measurement date (i.e., the first date on which both the number of shares and the option or stock-appreciation-right price are known). Accordingly, when the option or stock-appreciation-right price is equal to or greater than the market price on the measurement date, then no costs are allowed for contract costing purposes.

(3) In phantom-stock-type plans, contractors assign or attribute contingent shares of stock to employees as if the employees own the stock, even though the employees neither purchase the stock nor receive title to it. Under these plans, an employee's account may be increased by the equivalent of dividends issued and any appreciation in the market price of the stock over the price of the stock on the measurement date (i.e.; the first date the number of shares awarded is known). Such increases in employee accounts for dividend equivalents and market price appreciation are unallowable.

(j) *Pension costs*. (1) A pension plan is a deferred compensation plan that is established and maintained by one or more employers to provide systematically for paying benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employee. Additional benefits such as permanent and total disability and death payments and survivorship payments to beneficiaries of deceased employees may be treated as pension costs, provided the benefits are an integral part of the pension plan and meet all the criteria pertaining to pension costs.

(2) Pension plans are normally segregated into two types of plans: defined benefit or defined contribution pension plans. The cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of CAS 412, Composition and Measurement of Pension Costs, and CAS 413, Adjustment and Allocation of Pension Cost. The costs of all defined contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of CAS 412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth below in this subparagraph and in subparagraphs (j)(3), (4), (5), (6), and (7)-below.

(i) To be allowable in the current year, pension costs must be funded by the time set for filing the Federal income tax return or any extension thereof. Pension costs assigned to the current year, but not funded by the tax return time, shall not be allowable in any subsequent year.

(ii) Pension payments must be reasonable in amount and be paid pursuant to (A) an agreement entered into in good faith between the contractor and employees before the work or services are performed and (B) the terms and conditions of the established plan. The cost of changes in pension plans which are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future are not allowable.

(iii) Except as provided for early retirement benefits in subparagraph (j)(6) below, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the option of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of-living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(3) *Defined benefit pension plans*. This subparagraph covers pension plans in which the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits. The cost limitations and exclusions pertaining to defined benefit plans are as follows:

(i) Normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see CAS 412.40(a)(1)) assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see CAS 412.50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in those years. The interest earned on such premature funding, based on the valuation rate of return, may be excluded from future years' computations of pension costs in accordance with CAS 412.50(a)(7).

(iii) Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in CAS 413.50(c)(5). Determination of unallowable costs shall be made in accordance with the actuarial method used in calculating pension costs.

(iv) Allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGC) under ERISA Section 4062 or 4064 arising from terminating an employee deferred compensation plan will be considered on a case-by-case basis; provided that if insurance was required by the PBGC under ERISA Section 4023, it was so obtained and the indemnification payment is not recoverable under the insurance. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205-19(a)(3) and (b), in the indemnification payment to the extent of its fair share.

(4) *Defined contribution pension plans.* This subparagraph covers those pension plans in which the contributions to be made are established in advance and the level of benefits is determined by the contributions made. It also covers profit sharing, savings plans, and other such plans provided the plans fall within the definition of a pension plan in subparagraph (j)(1) above.

(i) The pension cost assignable to a cost accounting period is the net contribution required to be made for that period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of ERISA (see CAS 412.50(c)(3)) will be allowable in those future accounting periods when the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding been made in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded to the trust before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in such years.

(iii) The provisions of subdivision (j)(3)(iv) above concerning payments to PBGC apply to defined contribution plans.

(5) *Pension plans using pay-as-you-go methods.* A pension plan using pay-as-you-go methods is a plan in which the contractor recognizes pension cost only when benefits are paid to retired employees or their beneficiaries. Regardless of whether the payment of pension benefits contribution can or cannot be compelled, allowable costs for these types of plans shall not exceed an amount computed as follows:

(i) Compute, by using an actuarial cost method, the plan's actuarial liability for benefits earned by plan participants. This entire liability is always unfunded for a pay-as-you-go plan.

(ii) Compute a level amount which, including an interest equivalent, would amortize the unfunded actuarial liability over a period of no less than 10 or more than 40 years from the inception of the liability.

(iii) Compute, by using an actuarial cost method, a normal cost for the period.

(iv) The sum of (ii) and (iii) above represents the amount of pension costs assignable to the current period. This amount, however, is limited to the amount paid in the year.

(v) For purposes of determining contract cost where a pay-as-you-go plan is initiated as either a supplemental plan or an additional but separate plan to a basic funded plan, the plans will be treated as one plan; e.g., the actuarial cost method, past service amortization period, etc., of the basic plan will be used on the supplemental or additional pay-as-you-go plan in determining the proper costs assignable to the current period. Any costs in excess of those determined by using the actuarial cost method and assumptions of the basic plan are unallowable. However, where assumption for salary progressions, mortality rates of the participants, and so forth are significantly different, the assumptions used for the basic and supplemental plan may be different.

(vi) The requirements of subdivisions (j)(3)(i) through (iv) above are also applicable to pay-as-you-go plans.

(6) *Early retirement incentive plans.* An early retirement incentive plan is a plan under which employees receive a bonus or incentive, over and above the requirement of the basic pension plan, to retire early. These plans normally are not applicable to all participants of the basic plan and do not represent life income settlements, and as such would not qualify as pension costs. However, for contract costing purposes, early retirement incentive payments are allow-

able subject to the pension cost criteria contained in subdivisions (j)(3)(i) through (iv) provided—

(i) The costs are accounted for and allocated in accordance with the contractor's system of accounting for pension costs (see subdivision (j)(5)(v) above for supplemental pension benefits);

(ii) The payments are made in accordance with the terms and conditions of the contractor's plan;

(iii) The plan is applied only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The total of the incentive payments to any employee may not exceed the amount of the employee's annual salary for the previous fiscal year before the employee's retirement.

(7) *Employee stock ownership plans (ESOP)* (i) An ESOP is an individual stock bonus plan designed specifically to invest in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESCT) may be in the form of cash, stock, or property. Costs of ESOP's are allowable subject to the following conditions:

(A) Contributions by the contractor in any one year may not exceed 15 percent (25 percent when a money purchase plan is included) of salaries and wages of employees participating in the plan in any particular year.

(B) The contribution rate (ratio of contribution to salaries and wages of participating employees) may not exceed the last approved contribution rate except when approved by the contracting officer based upon justification provided by the contractor. When no contribution was made in the previous year for an existing ESOP, or when a new ESOP is first established, and the contractor proposes to make a contribution in the current year, the contribution rate shall be subject to the contracting officer's approval.

(C) When a plan or agreement exists wherein the liability for the contribution can be compelled for a specific year, the expense associated with that liability is assignable only to that period. Any portion of the contribution not funded by the time set for filing of the Federal income tax return for that year or any extension thereof shall not be allowable in subsequent years.

(D) When a plan or agreement exists wherein the liability for the contribution cannot be compelled, the amount contributed for any year is assignable to that year provided the amount is funded by the time set for filing of the Federal income tax return for that year.

(E) When the contribution is in the form of stock, the value of the stock contribution shall be limited to the fair market value of the stock on the date that title is effectively transferred to the trust. Cash contributions shall be allowable only when the contractor furnishes evidence satisfactory to the contracting officer demonstrating that stock purchases by the ESOT are or will be at a fair market price; e.g., makes arrangements with the trust permitting the contracting officer to examine purchases of stock by the trust to determine that prices paid are at fair market value. When excessive prices are paid, the amount of the excess will be credited to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the excess price over fair market value shall be credited to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan. When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

(ii) Amounts contributed to an ESOP arising from either (A) an additional investment tax credit (see 1975 Tax Reduction Act—TRASOP's); or (B) a payroll-based tax credit (see Economic Recovery Tax Act of 1981) are unallowable.

(iii) The requirements of subdivision (j)(3)(ii) above are applicable to Employee Stock Ownership Plans.

(k) *Deferred compensation.* (1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of receipt of compensation by the employee. Deferred compensation does not include the amount of year-end accruals for salaries, wages, or bonuses that are paid within a reasonable period of time after the end of a cost accounting period. Subject to 31.205-6(a), deferred awards are allowable when they are based on current or future services. Awards made in periods subsequent to the period when the work being remunerated was performed are not allowable.

(2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of CAS 415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of CAS 415 are allowable to the extent they would have been allowable under prior acquisition regulations.

(l) Reserved.

(m) *Fringe benefits.* Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. The cost of fringe benefits, including, but not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans, is allowable if reasonable. The costs of fringe benefits are allowable to the extent that they are required by law, employer-employee agreement, or as an established policy of the contractor.

31.205-7 Contingencies.

(a) "Contingency," as used in this subpart, means a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable for historical costing purposes because such costing deals with costs incurred and recorded on the contractor's books. However, in some cases, as for example, terminations, a contingency factor may be recognized when it is applicable to a past period to give recognition to minor unsettled factors in the interest of expediting settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; e.g., anticipated costs of rejects and defective work. Contingencies of this category are to be included in the estimates of future costs so as to provide the best estimate of performance cost.

(2) Those that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; e.g., results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage. (See, for example, 31.205-6(g), 31.205-19, and 31.205-24.)

31.205-8 Contributions and donations.

Contributions and donations are unallowable.

31.205-9 Reserved.

31.205-10 Cost of money.

(a) *Facilities capital cost of money.*

(1) *General* (i) Facilities capital cost of money (cost of capital committed to facilities) is an imputed cost determined by applying a cost-of-money rate to facilities capital employed in contract performance. A cost-of-money rate is uniformly imputed to all contractors (see subdivision (ii) below). Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowings (see 31.205-20).

(ii) CAS 414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to facilities. Cost-of-money factors are developed on Form CASB-CMF, broken down by overhead pool at the business unit, using (A) business-unit facilities capital data, (B) overhead allocation base data, and (C) the cost-of-money rate, which is based on interest rates specified by the Secretary of the Treasury under 50 U.S.C. App. 1215(b)(2).

(2) *Allowability.* Whether or not the contract is otherwise subject to CAS, facilities capital cost of money is allowable if—

(i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with CAS 414;

(ii) The contractor maintains adequate records to demonstrate compliance with this standard; and

(iii) The estimated facilities capital cost of money is specifically identified or proposed in cost proposals relating to the contract under which this cost is to be claimed.

(3) *Accounting.* The facilities capital cost of money need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) *Payment.* Facilities capital cost of money that is (i) allowable under subparagraph (2) above and (ii) calculated, allocated, and documented in accordance with this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

(b) *Cost of money as an element of the cost of capital assets under construction.*

(1) *General* (i) Cost of money as an element of the cost of capital assets under construction is an imputed cost determined by applying a cost-of-money rate to the investment in tangible and intangible capital assets while they are being constructed, fabricated, or developed for a contractor's own use. Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowing (see 31.205-20).

(ii) CAS 417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to capital assets under construction, fabrication, or development.

(2) *Allowability* (i) Whether or not the contact is otherwise subject to CAS, and except as specified in subdivision (ii) below, the cost of money for capital assets under construction, fabrication, or development is allowable if—

(A) The cost of money is calculated, allocated to contracts, and costed in accordance with CAS 417;

(B) The contractor maintains adequate records to demonstrate compliance with this standard; and

(C) The cost of money for tangible capital assets if included in the capitalized cost that provides the basis for allowable depreciation costs, or, in the case of intangible capital assets, the cost of money is included in the cost of those assets for which amortization costs are allowable.

(ii) Actual interest cost in lieu of the calculated imputed cost of money for capital assets under construction, fabrication, or development is unallowable.

(3) *Accounting*. The cost of money for capital assets under construction need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) *Payment*. The cost of money for capital assets under construction that is allowable under subparagraph (2) above of this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

31.205-11 Depreciation.

(a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor's operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.

(b) Contractors having contracts subject to CAS 409, Depreciation of Tangible Capital Assets, must adhere to the requirement of that standard for all fully CAS-covered contracts and may elect to adopt the standard for all other contracts. All requirements of CAS 409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt CAS 409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which CAS 409 is not applied.

(c) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable contract cost, if the contractor is able to demonstrate that it is reasonable and allocable (but see paragrpah (i) below).

(d) Depreciation shall be considered reasonable if the contractor follows policies and procedures that are—

(1) Consistent with those followed in the same cost center for business other than Government;

(2) Reflected in the contractor's books of accounts and financial statements; and

(3) Both used and acceptable for Federal income tax purposes.

(e) When the depreciation reflected on a contractor's books of accounts and financial statements differs from that used and acceptable for Federal income tax purposes, reimbursement shall be based on the asset cost amortized over the estimated useful life of the property using depreciation methods (straight line, sum of the years' digits, etc.) acceptable for income tax purposes. Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-Government business.

(f) Depreciation for reimbursement purposes in the case of tax-exempt organizations shall be determined on the basis described in paragraph (e) immediately above.

(g) Special considerations are required for assets acquired before the effective date of this cost principle if, on that date, the undepreciated balance of these assets resulting from depreciation policies and procedures used previously for Government contracts and subcontracts is different from the undepreciated balance on the books and financial statements. The undepreciated balance for contract cost purposes shall be depreciated over the remaining life using the methods and lives followed for book purposes. The aggregate depreciation of any asset allowable after the effective date of this 31.205-11 shall not exceed the cost basis of the asset less any depreciation allowed or allowable under prior acquisition regulations.

(h) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives in paragraph (a) above, vary with volume of production or use of multishift operations.

(i) In the case of emergency facilities covered by certificates of necessity, a contractor may elect to use normal depreciation without requesting a determination of "true depreciation," or may elect to use either normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board (EFDB). The method elected must be followed consistently throughout the life of the emergency facility. When an election is made to use normal depreciation, the criteria in paragraphs (c), (d), (e), and (f) above shall apply for both the emergency period and the post-emergency period. When an election is made to use "true depreciation", the amount allowable as depreciation—

(1) With respect to the emergency period (five years), shall be computed in accordance with the determination of the EFDB and allocated ratably over the full five year emergency period; *provided* no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and

(2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful life provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

(j) No depreciation, rental, or use charge shall be allowed on property acquired at no cost from the Government by the contractor or by any division, subsidiary, or affiliate of the contractor under common control.

(k) The depreciation on any item which meets the criteria for allowance at a "price" under 31.205-26(e) may be based on that price, provided the same policies and procedures are used for costing all business of the using division, subsidiary, or organization under common control.

(l) No depreciation or rental shall be allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but see 31.109(h)(2)). In determining the charge, consideration shall be given to cost, total estimated useful life at the time of negotiations, effect of any increased maintenance charges or decreased efficiency due to age, and the amount of depreciation previously charged to Government contracts or subcontracts.

(m) CAS 404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with CAS 404 and FAS-13 requires that such leased assets (capital leases) be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the leased life as amortization charges as appropriate. Assets whose leases are classified as capital leases under FAS-13 are subject to the requirements of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

(1) Rental costs under a sale and leaseback arrangement shall be allowable up to the amount that would have been allowed had the contractor retained title to the property.

(2) Capital leases, as defined in FAS-13, for all real and personal property, between any related parties are subject to the requirements of this subparagraph 31.205-11(m). If it is determined that the terms of the lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges shall not be allowed in excess of those which would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(3) Assets acquired under leases that the contractor must capitalize under FAS-13 shall not be treated as purchased assets for contract purposes if the leases are covered by 31.205-36(b)(4).

31.205-12 Economic planning costs.

(a) This category includes costs of generalized long-range management planning that is concerned with the future overall development of the contractor's business and that may take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business. Economic planning costs do not include organization or reorganization costs covered by 31.205-27.

(b) Economic planning costs are allowable as indirect costs to be properly allocated.

(c) Research and development and engineering costs designed to lead to new products for sale to the general public are not allowable under this principle.

31.205-13 Employee morale, health, welfare, food service, and dormitory costs and credits.

(a) Aggregate costs incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance (less income generated by these activities) are allowable, except as limited by paragraph (b) immediately below, and to the extent that the net amount is reasonable. Some examples are house publications, health clinics, recreation, employee counseling services, and food and dormitory services, which include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the contractor's employees at or near the contractor's facilities.

(b) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even basis. Losses sustained because food services or lodging accommodations are furnished without charge or at prices or rates which would not accomplish the above objective are not allowable. A loss may be allowed, however, to the extent the contractor can demonstrate that unusual circumstances exist (e.g., (i) where the contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available or (ii) where it is necessary to operate a facility at a lower volume than the facility could economically support) such that, even with efficient management, operating the services on a break-even basis would require charging inordinately high prices or prices or rates higher than those charged by commercial establishments offering the same services in the same geographical area. Cost of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

(c) When the contractor has an arrangement authorizing an employee association to provide or operate a service, such as vending machines in the contractor's plant, and retain the profits, such profits shall be treated in the same manner as if the contractor were providing the service (but see paragraph (d) immediately below).

(d) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, may be included as costs incurred under paragraph (a) above only to the extent that the contractor demonstrates that an equivalent amount of the costs incurred by the employee organization would be allowable if directly incurred by the contractor.

31.205-14 Entertainment costs.

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-13 and 31.205-43).

31.205-15 Fines and penalties.

Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, or local laws and regulations are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

31.205-16 Gains and losses on disposition of depreciable property or other capital assets.

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see paragraph (d) below).

(b) Gains and losses on disposition of tangible capital assets, incuding those acquired under capital leases (see 31.205-11(m)), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance (except see subdivisions (c)(2)(i) or (ii) below).

(c) Special considerations apply to an involuntary conversion which occurs when a contractor's property is destroyed by events over which the owner has no control, such as fire, windstorm, flood, accident, theft, etc., and an insurance award is recovered. The following governs involuntary conversions:

(1) When there is a cash award and the converted asset is not replaced, gain or loss shall be recognized in the period of disposition. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost of the asset and its undepreciated balance.

(2) When the converted asset is replaced, the contractor shall either—

(i) Adjust the depreciable basis of the new asset by the amount of the total realized gain or loss; or

(ii) Recognize the gain or loss in the period of disposition, in which case the Government shall participate to the same extent as outlined in subparagraph (c)(1) above.

(d) Gains and losses on the disposition of depreciable property shall not be recognized as a separate charge or credit when—

(1) Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under 31.205-11; or

(2) The property is exchanged as part of the purchase price of a similar item, and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other disposition shall be considered on a case-by-case basis.

(f) Gains and losses of any nature arising from the sale or exchange of capital assets other than depreciable property shall be excluded in computing contract costs.

31.205-17 Idle facilities and idle capacity costs.

(a) "Costs of idle facilities or idle capacity," as used in this subsection, means costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation.

"Facilities," as used in this subsection, means plant or any portion thereof (including land integral to the operation), equipment, individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the contractor.

"Idle capacity," as used in this subsection, means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 percent operating time on a one-shift basis, less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multiple-shift basis may be used in the calculation instead of a one-shift basis if it can be shown that this amount of usage could normally be expected for the type of facility involved.

"Idle facilities," as used in this subsection, means completely unused facilities that are excess to the contractor's current needs.

(b) The costs of idle facilities are unallowable unless the facilities—

(1) Are necessary to meet fluctuations in workload; or

. (2) Were necessary when acquired and are now idle because of changes in requirements, production economies, reorganization, termination, or other causes which could not have been reasonably foreseen. (Costs of idle facilities are allowable for a reasonable period, ordinarily not to exceed 1 year, depending upon the initiative taken to use, lease, or dispose of the idle facilities (but see 31.205-42)).

(c) Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

(d) Any costs to be paid directly by the Government for idle facilities or idle capacity reserved for defense mobilization production shall be the subject of a separate agreement.

31.205-18 Independent research and development and bid and proposal costs.

(a) *Definitions.*

"Applied research," as used in this subsection, means that effort which (1) normally follows basic research, but may not be severable from the related basic research, (2) attempts to determine and exploit the potential of scientific discoveries or improvements in technology, materials, processes, methods, devices, or techniques, and (3) attempts to advance the state of the art. Applied research does not include efforts whose principal aim is design, development, or test of specific items or services to be considered for sale; these efforts are within the definition of the term "development," defined below.

"Basic research," as used in this subsection, means that research which is directed toward increase of knowledge in science. The primary aim of basic research is a fuller knowledge or understanding of the subject under study, rather than any practical application thereof.

"Bid and proposal (B&P) costs," as used in this subdivision, means the costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-Government contracts. The term does not include the costs of effort sponsored by a grant or cooperative agreement or required in contract performance.

"Company," as used in this subsection, means all divisions, subsidiaries, and affiliates of the contractor under common control.

"Development," as used in this subsection, means the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development includes the functions of design engineering, prototyping, and engineering testing. Development excludes: (1) subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or (2) development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

"Independent research and development (IR&D)" means a contractor's IR&D cost that is not sponsored by, or required in performance of, a contract or grant and that consists of projects falling within the four following areas: (1) basic research, (2) applied research, (3) development, and (4) systems and other concept formulation studies. IR&D effort shall not include technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.

"Systems and other concept formulation studies," as used in this subsection, means analyses and study efforts either related to specific IR&D efforts or directed toward identifying desirable new systems, equipments or components, or modifications and improvements to existing systems, equipments, or components.

(b) *Composition and allocation of costs.* The requirements of CAS 420, Accounting for Independent Research and Development Costs and Bid and Proposal Costs, are incorporated in their entirety and shall apply as follows—

(1) *Fully-CAS-covered contracts.* Contracts that are fully-CAS-covered shall be subject to all requirements of CAS 420

(2) *Modified-CAS-covered and non-CAS-covered contracts.* Contracts that are not CAS-covered or that contain terms or conditions requiring modified CAS coverage shall be subject to all requirements of CAS 420 *except* 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2), which are not then applicable. However, non-CAS covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring compliance with CAS 420, shall be subject to all the requirements of CAS 420. When the requirements of 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2) are not applicable, the following apply:

(i) IR&D and B&P costs shall be allocated to final cost objectives on the same basis of allocation used for the G&A expense grouping of the profit center (see 31.001) in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit centers or benefit the entire company, those costs shall be allocated through the G&A of the other profit centers or through the corporate G&A, as appropriate.

(ii) If allocations of IR&D or B&P through the G&A base do not provide equitable cost allocation, the contracting officer may approve use of a different base.

(c) *Allowability.* Except as provided in paragraph (d) below, costs for IR&D and B&P are allowable only in accordance with the following:

(1) *Companies required to negotiate advance agreements.*

(i) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding $4 million from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of Section 203 of Pub. L. 91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than $4 million in payments for IR&D and B&P from DOD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (Also see paragraph (b) above and 15.804.) The computation shall include full burdening pursuant to CAS 420.

(ii) When a company meets the criterion in (i) above, required advance agreements may be negotiated at the corporate level and/or with those profit centers that contract directly with the Government and that in the preceding year allocated recoverable IR&D and B&P costs exceeding $500,000, including burdening, to contracts and subcontracts for which the submission and certification of cost or pricing data were required (also see paragraph (b) above and 15.804). When ceilings are negotiated for separate profit centers of the company, the allowability of IR&D and B&P costs for any center that in its previous fiscal year did not reach the $500,000 threshold may be determined in accordance with subparagraph (c)(2) below.

(iii) Ceilings are the maximum dollar amounts of total IR&D and B&P costs that will be allowable for allocation over the appropriate base for that part of the company's operation covered by an advance agreement.

(iv) No IR&D and B&P cost shall be allowable if a company fails to initiate negotiation of a required advance agreement before the end of the fiscal year for which the agreement is required.

(v) When negotiations are held with a company meeting the $4 million criterion or with separate profit centers (when negotiations are held at that level under (ii) above), and if no advance agreement is reached, payment for IR&D and B&P costs shall be reduced below that which the company or profit center would have otherwise received. The amount of such reduced payment shall not exceed 75 percent of the amount which, in the opinion of the contracting officer, the company or profit center would be entitled to receive under an advance agreement. Written notification of the contracting officer's determination of a reduced amount shall be provided the contractor. In the event that an advance agreement is not reached before the end of the contractor's fiscal year for which the agreement is to apply, negotiations shall immediately be terminated, and the contracting officer shall furnish a determination of the reduced amount.

(vi) Contractors may appeal decisions of the contracting officer to reduce payment. The appeal shall be filed with the contracting officer within 30 days of receipt of the contracting officer's determination. (Also see Subpart 42.10.)

(2) *Companies not required to negotiate advance agreements.* Ceilings for allowable IR&D and B&P costs for companies not required to negotiate advance agreements in accordance with subparagraph (c)(1) above shall be established by a formula, either on a company-wide basis or by profit centers, computed as follows:

(i) Determine the ratio of IR&D/B&P costs to total sales (or other base acceptable to the contracting officer) for each of the preceding three years and average the two highest of these ratios; this average is the IR&D/B&P historical ratio;

(ii) Compute the average annual IR&D/B&P costs (hereafter called average), using the two highest of the preceding three years;

(iii) IR&D/B&P costs for the center for the current year which are not in excess of the product of the center's actual total sales (or other accepted base) for the current year and the IR&D/B&P historical ratio computed under (i) above (hereafter called product) shall be considered allowable only to the extent the product does not exceed 120 percent of the average. If the product is less than 80 percent of the average, costs up to 80 percent of the average shall be allowable.

(iv) However, at the discretion of the contracting officer, an advance agreement may be negotiated when the contractor can demonstrate that the formula would produce a clearly inequitable cost recovery.

(d) *Deferred IR&D and B&P costs.* (1) IR&D costs that were incurred in previous accounting periods are unallowable, except when a contractor has developed a specific product at its own risk in anticipation of recovering the development costs in the sale price of the product provided that—

(i) The total amount of IR&D costs applicable to the product can be identified;

(ii) The proration of such costs to sales of the product is reasonable;

(iii) The contractor had no Government business during the time that the costs were incurred or did not allocate IR&D costs to Government contracts except to prorate the cost of developing a specific product to the sales of that product; and

(iv) No costs of current IR&D programs are allocated to Government work except to prorate the costs of developing a specific product to the sales of that product.

(2) When deferred costs are recognized, the contract (except firm-fixed-price and fixed-price with economic price adjustment) will include a specific provision setting forth the amount of deferred IR&D costs that are allocable to the contract. The negotiation memorandum will state the circumstances pertaining to the case and the reason for accepting the deferred costs.

31.205-19 Insurance and indemnification.

(a) Insurance by purchase or by self-insuring includes coverage the contractor is required to carry, or to have approved, under the terms of the contract and any other coverage the contractor maintains in connection with the general conduct of its business. Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to CAS 416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation. However, approval of a contractor's insurance program in accordance with Part 28 does not constitute a determination as to the allowability of the program's cost. The amount of insurance costs which may be allowed is subject to the cost limitations and exclusions in the following subparagraphs.

(1) Costs of insurance required or approved, and maintained by the contractor pursuant to the contract, are allowable.

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable, subject to the following limitations:

(i) Types and extent of coverage shall follow sound business practice, and the rates and premiums must be reasonable.

(ii) Costs allowed for business interruption or other similar insurance must be limited to exclude coverage of profit.

(iii) The cost of property insurance premiums for insurance coverage in excess of the acquisition cost of the insured assets is allowable only when the contractor has a formal written policy assuring that in the event the insured property is involuntarily converted, the new asset shall be valued at the book value of the replaced asset plus or minus adjustments for differences between insurance proceeds and actual replacement cost. If the contractor does not have such a formal written policy, the cost of premiums for insurance coverage in excess of the acquisition cost of the insured asset is unallowable.

(iv) Costs of insurance for the risk of loss of or damage to Government property are allowable only to the extent that the contractor is liable for such loss or damage and such insurance does not cover loss or damage that results from willful misconduct or lack of good faith on the part of any of the contractor's directors or officers or other equivalent representatives.

(v) Contractors operating under a program of self-insurance must obtain approval of the program when required by 28.308(a).

(vi) Costs of insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation (see 31.205-6).

(3) Actual losses are unallowable unless expressly provided for in the contract, except—

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to CAS 416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of CAS 416. For contracts subject to CAS 416, and for those made subject to the self-insurance requirements of that Standard as a result of the contractor's having established a self-insurance program (see paragraph (a) above), actual losses may be used as a basis for charges under a self-insurance program when the actual amount of losses will not differ significantly from the projected average losses for the accounting period (see 4 CFR 416.50(a)(2)(ii)).

(ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of doing business and that are not covered by insurance are allowable.

(4) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials or workmanship is unallowable. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense.

(b) If purchased insurance is available, the charge for any self-insurance coverage plus insurance administration expenses shall not exceed the cost of comparable purchased insurance plus associated insurance administration expenses.

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of CAS 416. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the insurance will be considered purchased insurance.

(d) The allowability of premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) shall not exceed the amount (plus reasonable fronting company charges for services rendered) which the contractor would have been allowed had it insured directly with the captive insurer.

(e) Self-insurance charges for risks of catastrophic losses are not allowable (see 28.308(e)).

(f) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (d) above.

(g) Late premium payment charges related to employee deferred compensation plan insurance incurred pursuant to Section 4307 (29 U.S.C. 1307) or Section 4023 (29 U.S.C. 1323) of the Employee Retirement Income Security Act of 1974 are unallowable.

31.205-20 Interest and other financial costs.

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, costs of preparing and issuing stock rights, and directly associated costs are unallowable except for interest assessed by State or local taxing authorities under the conditions specified in 31.205-41 (but see 31.205-28).

31.205-21 Labor relations costs.

Costs incurred in maintaining satisfactory relations between the contractor and its employees, including costs of shop stewards, labor management committees, employee publications, and other related activities, are allowable.

31.205-22 Lobbying costs.

(a) Lobbying is defined as any activity or communication that is intended or designed (1) to directly influence members of the U.S. Congress or State and local legislatures, their staffs, or the staffs of committees of these bodies to favor or oppose pending, proposed, or existing legislation, appropriations, or other official actions of these bodies, their members, or their committees, or (2) to engage in any campaign to directly encourage others to do so. Except as provided in paragraph (c) below, lobbying includes, but is not limited to, appearances before any legislative committee or subcommittee and written or oral communications, including face-to-face discussions or conferences, telephone conversations, paid advertisements, and the sending of telegrams or letters.

(b) The costs of lobbying, including the applicable portion of the salaries and fees of those individuals engaged in lobbying efforts on behalf of a contractor, whether or not the individuals are registered as lobbyists under any applicable law, are unallowable.

(c) Legislative liaison activities, such as attendance at committee hearings and gathering information regarding pending legislation, are not lobbying and are allowable. In addition, written or oral communications, appearances before legislative committees and subcommittees, and meetings with legislative representatives are allowable legislative liaison activities when such efforts are undertaken in conjunction with a legislative public hearing or meeting in response to a public notice, or a specific invitation or request from a legislative source, and the notice, invitation, or request is documented. However, for the costs to be allowable, the contractor shall maintain and make available to the Government records and documentation sufficient to identify the costs and clearly establish the nature and purpose of the legislative liaison activity to which the costs relate.

31.205-23 Losses on other contracts.

An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) is unallowable.

31.205-24 Maintenance and repair costs.

(a) Costs necessary for the upkeep of property (including Government property, unless otherwise provided for) that neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows (but see 31.205-11):

(1) Normal maintenance and repair costs are allowable.

(2) Extraordinary maintenance and repair costs are allowable, provided those costs are allocated to the applicable periods for purposes of determining contract costs (but see 31.109).

(b) Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to CAS 404, Capitalization of Tangible Assets, are allowable only on a depreciation basis.

31.205-25 Manufacturing and production engineering costs.

(a) The costs of manufacturing and production engineering effort as described in (1) through (4) below are all allowable:

(1) Developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services;

(2) Developing and deploying pilot production lines;

(3) Improving current production functions, such as plant layout, production scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques, and tooling analysis (including tooling design and application improvements); and

(4) Material and manufacturing producibility analysis for production suitability and to optimize manufacturing processes, methods, and techniques.

(b) This cost principle does not cover:

(1) Basic and applied research effort (as defined in 31.205-18(a)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by 31.205-18, Independent research and development costs; and

(2) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools and techniques that are intended for sale is also governed by 31.205-18.

(c) Where manufacturing or production development costs are capitalized or required to be capitalized under the contractor's capitalization policies, allowable cost will be determined in accordance with the requirements of 31.205-11, Depreciation.

31.205-26 Material costs.

(a) Material costs include the costs of such items as raw materials, parts, sub-assemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs, consideration shall be given to reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work). These costs are allowable, subject to the requirements of paragraphs (b) through (e) below.

(b) Costs of material shall be adjusted for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors. Such income and other credits shall either be credited directly to the cost of the material or be allocated as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, lost discounts need not be credited.

(c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs; *provided*, such adjustments relate to the period of contract performance.

(d) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable. When estimates of future material costs are required, current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.

(e) Allowance for all materials, supplies, and services that are sold or transferred between any divisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at a price when it is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary, or affiliate of the contractor under a common control, and when the price—

(1) Is or is based on an "established catalog or market price of commercial items sold in substantial quantities to the general public" in accordance with 15.804; or

(2) Is the result of "adequate price competition" in accordance with 15.804 and is the price at which an award was made to the affiliated organization after obtaining quotations on an equal basis from such organization and one or more outside sources that produce the item or its equivalent in significant quantity.

(3) Provided, that in either subparagraph (1) or (2) above—

(i) The price is not in excess of the transferor's current sales price to its most favored customer (including any division, subsidiary or affiliate of the contractor under a common control) for a like quantity under comparable conditions; and

(ii) The contracting officer has not determined the price to be unreasonable.

(f) The price determined in accordance with subparagraph (e)(1) above should be adjusted to reflect the quantities being acquired and may be adjusted to reflect actual cost of any modifications necessary because of contract requirements.

31.205-27 Organization costs.

(a) Except as provided in paragraph (b) below, expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, or (2) raising capital (net worth plus long-term liabilities), are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counselors, whether or not employees of the contractor. Unallowable "reorganization" costs include the cost of any change in the contractor's financial structure, excluding administrative costs of short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.

(b) The cost of activities primarily intended to provide compensation will not be considered organizational costs subject to this subsection, but will be governed by 31.205-6. These activities include acquiring stock for (1) executive bonuses, (2) employee savings plans, and (3) employee stock ownership plans.

31.205-28 Other business expenses.

The following types of recurring costs are allowable when allocated on an equitable basis:

(a) Registry and transfer charges resulting from changes in ownership of securities issued by the contractor.

(b) Cost of shareholders' meetings.

(c) Normal proxy solicitations.

(d) Preparing and publishing reports to shareholders.

(e) Preparing and submitting required reports and forms to taxing and other regulatory bodies.

(f) Incidental costs of directors' and committee meetings.

(g) Other similar costs.

31.205-29 Plant protection costs.

Costs of items such as (a) wages, uniforms, and equipment of personnel engaged in plant protection, (b) depreciation on plant protection capital assets, and (c) necessary expenses to comply with military requirements, are allowable.

31.205-30 Patent costs.

(a) The following patent costs are allowable to the extent that they are incurred as requirements of a Government contract (but see 31.205-33):

(1) Costs of preparing invention disclosures, reports, and other documents.

(2) Costs for searching the art to the extent necessary to make the invention disclosures.

(3) Other costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is to be conveyed to the Government.

(b) General counseling services relating to patent matters, such as advice on patent laws, regulations, clauses, and employee agreements, are allowable (but see 31.205-33).

(c) Other than those for general counseling services, patent costs not required by the contract are unallowable. (See also 31.205-37.)

31.205-31 Plant reconversion costs.

Plant reconversion costs are those incurred in restoring or rehabilitating the contractor's facilities to approximately the same condition existing immediately before the start of the Government contract, fair wear and tear excepted. Reconversion costs are unallowable except for the cost of removing Government property and the restoration or rehabilitation costs caused by such removal. However, in special circumstances where equity so dictates, additional costs may be allowed to the extent agreed upon before costs are incurred. Care should be exercised to avoid duplication through allowance as contingencies, additional profit or fee, or in other contracts.

31.205-32 Precontract costs.

Precontract costs are those incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such occurrence is necessary to comply with the proposed contract delivery schedule. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (see 31.109.)

31.205-33 Professional and consultant service costs.

(a) Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor are allowable subject to paragraphs (b), (c), (d), and (e) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government (but see 31.205-30).

(b) In determining the allowability of costs (including retainer fees) in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors, among others, should be considered:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the contractor's capability in the particular area.

(3) The past pattern of such costs, particularly in the years prior to the award of Government contracts.

(4) The impact of Government contracts on the contractor's business.

(5) Whether the proportion of Government work to the contractor's total business is such as to influence the contractor in favor of incurring the cost, particularly when the services rendered are not of a continuing nature and have little relationship to work under Government contracts.

(6) Whether the service can be performed more economically by employment rather than by contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fee charged, especially on non-government contracts.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service; estimate of time required; rate of compensation; termination provisions).

(c) Retainer fees to be allowable must be supported by evidence that—

(1) The services covered by the retainer agreement are necessary and customary;

(2) The level of past services justifies the amount of the retainer fees (if no services were rendered, fees are not automatically unallowable); and

(3) The retainer fee is reasonable in comparison with maintaining an in-house capability to perform the covered services, when factors such as cost and level of expertise are considered.

(d) Costs of legal, accounting, and consulting services and directly associated costs incurred in connection with organization and reorganization (also see 31.205-27), defense of antitrust suits, or the prosecution of claims against the Government are unallowable. Such costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the contract.

(e) Except for retainers, fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (Also see 31.205-38(c).)

31.205-34 Recruitment costs.

(a) Subject to paragraphs (b) and (c) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, the following costs are allowable:

(1) Costs of help-wanted advertising.

(2) Costs of operating an employment office needed to secure and maintain an adequate labor force.

(3) Costs of operating an aptitude and educational testing program.

(4) Travel costs of employees engaged in recuiting personnel.

(5) Travel costs of applicants for interviews.

(6) Costs for employment agencies, not in excess of standard commercial rates.

(b) Help-wanted advertising costs are unallowable if the advertising—

(1) Is for personnel other than those required to perform obligations under a Government contract;

(2) Does not describe specific positions or classes of positions;

(3) Is excessive relative to the number and importance of the positions or to the industry practices;

(4) Includes material that is not relevant for recruitment purposes, such as extensive illustrations or descriptions of the company's products or capabilities;

(5) Is designed to "pirate" personnel from another Government contractor; or

(6) Includes color (in publications).

(c) Excessive compensation costs offered to prospective employees to "pirate" them from another Government contractor are unallowable. Such excessive costs may include salaries, fringe benefits, or special emoluments which are in excess of standard industry practices or the contractor's customary compensation practices.

31.205-35 Relocation costs.

(a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. The following types of costs are allowable as noted, subject to paragraphs (c) and (d) below:

(1) Cost of travel of the employee and members of the immediate family (see 31.205-46) and transportation of the household and personal effects to the new location.

(2) Cost of finding a new home, such as advance trips by employees and spouses to locate living quarters, and temporary lodging during the transition periods not exceeding separate cumulative totals of 60 days for employees and 45 days for spouses and dependents, including advance trip time.

(3) Closing costs (i.e., brokerage fees, legal fees, appraisal fees, points, finance charges, etc.) incident to the disposition of actual residence owned by the employee when notified of transfer, except that these costs when added to the costs described in subparagraph (a)(4) below shall not exceed 14 percent of the sales price of the property sold.

(4) Continuing costs of ownership of the vacant former actual residence being sold, such as maintenance of building and grounds (exclusive of fixing up expenses), utilities, taxes, property insurance, mortgage interest, after settlement date or lease date of new permanent residence, except that these costs when added to the costs described in subparagraph

(a)(3) above, shall not exceed 14 percent of the sales price of the property sold.

(5) Other necessary and reasonable expenses normally incident to relocation, such as disconnecting and connecting household appliances; automobile registration; driver's license and use taxes; cutting and fitting rugs, draperies, and curtains; forfeited utility fees and deposits; and purchase of insurance against damage to or loss of personal property while in transit.

(6) Costs incident to acquiring a home in a new location, except that (i) these costs will not be allowable for existing employees or newly recruited employees who, before the relocation, were not homeowners and (ii) the total costs shall not exceed 5 percent of the purchase price of the new home.

(7) Mortgage interest differential payments, except that these costs are not allowable for existing or newly recruited employees who, before the relocation, were not homeowners and the total payments are limited to an amount determined as follows:

(i) The difference between the mortgage interest rates of the old and new residences times the current balance of the old mortgage times 3 years.

(ii) When mortgage differential payments are made on a lump sum basis and the employee leaves or is transferred again in less than 3 years, the amount initially recognized shall be proportionately adjusted to reflect payments only for the actual time of the relocation.

(8) Rental differential payments covering situations where relocated employees retain ownership of a vacated home in the old location and rent at the new location. The rented quarters at the new location must be comparable to those vacated, and the allowable differential payments may not exceed the actual rental costs for the new home, less the fair market rent for the vacated home times 3 years.

(9) Cost of canceling an unexpired lease.

(b) The costs described in paragraph (a) above must also meet the following criteria to be considered allowable:

(1) The move must be for the benefit of the employer.

(2) Reimbursement must be in accordance with an established policy or practice that is consistenly followed by the employer and is designed to motivate employees to relocate promptly and economically.

(3) The costs must not otherwise be unallowable under Subpart 31.2.

(4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except that for miscellaneous costs of the type discussed in subparagraph (a)(5) above, a flat amount, not to exceed $1,000, may be allowed in lieu of actual costs.

(c) The following types of costs are not allowable:

(1) Loss on sale of a home.

(2) Costs incident to acquiring a home in a new location as follows:

(i) Real estate brokers fees and commissions.

(ii) Cost of litigation.

(iii) Real and personal property insurance against damage or loss of property.

(iv) Mortgage life insurance.

(v) Owner's title policy insurance when such insurance was not previously carried by the employee on the old residence (however, cost of a mortgage title policy is allowable).

(vi) Property taxes and operating or maintenance costs.

(3) Continuing mortgage principal payments on residence being sold.

(4) Payments for employee income or FICA (social security) taxes incident to reimbursed relocation costs.

(5) Payments for job counseling and placement assistance to employee spouses and dependents who were not employees of the contractor at the old location.

(6) Costs incident to furnishing equity or nonequity loans to employees or making arrangements with lenders for employees to obtain lower-than-market rate mortgage loans.

(d) If relocation costs for an employee have been allowed either as an allocable indirect or direct cost, and the employee resigns within 12 months for reasons within the employee's control, the contractor shall refund or credit the relocation costs to the Government.

(e) Subject to the requirements of paragraphs (a) through (d) above, the costs of family movements and of personnel movements of a special or mass nature are allowable. The cost, however, should be assigned on the basis of work (contracts) or time period benefited.

31.205-36 Rental costs.

(a) This subsection is applicable to the cost of renting or leasing real or personal property, except ADPE (see 31.205-2), acquired under "operating leases" as defined in Statement of Financial Accounting Standards No. 13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(l) requires that assets acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the lease term as amortization charges, as appropriate (but see subparagraph (b)(4) below).

(b) The following costs are allowable:

(1) Rental costs under operating leases, to the extent that the rates are reasonable at the time of the lease decision, after consideration of (i) rental costs of comparable property, if any; (ii) market conditions in the area; (iii) the type, life expectancy, condition,

and value of the property leased; (iv) alternatives available; and (v) other provisions of the agreement.

(2) Rental costs under a sale and leaseback arrangement only up to the amount the contractor would be allowed if the contractor retained title.

(3) Charges in the nature of rent for property between any divisions, subsidiaries, or organization under common control, to the extent that they do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance (excluding interest or other unallowable costs pursuant to Part 31), provided that no part of such costs shall duplicate any other allowed cost. Rental cost of personal property leased from any division, subsidiary, or affiliate of the contractor under common control, that has an established practice of leasing the same or similar property to unaffiliated lessees shall be allowed in accordance with subparagraph (b)(1) above.

(4) Rental costs under leases entered into before March 1, 1970 for the remaining term of the lease (excluding options not exercised before March 1, 1970) to the extent they would have been allowable under Defense Acquisition Regulation (Formerly ASPR) 15-205.34 or Federal Procurement Regulations section 1-15.205-34 in effect 1 January 1969.

(c) The allowability of rental costs under unexpired leases in connection with terminations is treated in 31.205-42(e).

31.205-37 Royalties and other costs for use of patents.

(a) Royalties on a patent or amortization of the cost of purchasing a patent or patent rights necessary for the proper performance of the contract and applicable to contract products or processes are allowable unless—

(1) The Government has a license or the right to a free use of the patent;

(2) The patent has been adjudicated to be invalid, or has been administratively determined to be invalid;

(3) The patent is considered to be unenforceable; or

(4) The patent is expired.

(b) Care should be exercised in determining reasonableness when the royalties may have been arrived at as a result of less-than-arm's-length bargaining; e.g., royalties—

(1) Paid to persons, including corporations, affiliated with the contractor;

(2) Paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or

(3) Paid under an agreement entered into after the contract award.

(c) In any case involving a patent formerly owned by the contractor, the royalty amount allowed should not exceed the cost which would have been allowed had the contractor retained title.

(d) See 31.109 regarding advance agreements.

31.205-38 Selling costs.

(a) Selling costs arise in the marketing of the contractor's products and include costs of sales promotions, negotiation, liaison between Government representatives and contractor's personnel, and related activities.

(b) Selling costs are allowable to the extent that they are reasonable and are allocable to Government business (but see 31.109 and 31.205-1). Allocability of selling costs shall be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use for its own requirements. Selling costs incurred in connection with potential and actual Foreign Military Sales as defined by the Arms Export Control Act, or foreign sales of military products shall not be allocable to U.S. Government contracts for U.S. Government requirements.

(c) Notwithstanding paragraph (b) above, sellers' or agents' compensation, fees, commissions, percentages, retainer, or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the contractor for the purpose of securing business (see subsection 3.408-2).

31.205-39 Service and warranty costs.

Service and warranty costs include those arising from fulfillment of any contractual obligation of a contractor to provide services such as installation, training, correcting defects in the products, replacing defective parts, and making refunds in the case of inadequate performance. When not inconsistent with the terms of the contract, such service and warranty costs are allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

31.205-40 Special tooling and special test equipment costs.

(a) The terms "special tooling" and "special test equipment" are defined in 45.101.

(b) The cost of special tooling and special test equipment used in performing one or more Government contracts is allowable and shall be allocated to the specific Government contract or contracts for which acquired, except that the cost of (1) items acquired by the contractor before the effective date of the contract (or replacement of such items), whether or not altered or adapted for use in performing the contract, and (2) items which the contract schedule specifically excludes, shall be allowable only as depreciation or amortization.

sistent with 31.201-4 and 31.203(c). The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

31.205-43 Trade, business, technical and professional activity costs.

The following types of costs are allowable:

(a) Memberships in trade, business, technical, and professional organizations.

(b) Subscriptions to trade, business, professional, or other technical periodicals.

(c) Meetings and conferences, including meals, transportation, rental of meeting facilities and other incidental costs when the primary purposes of the incurrence of the costs is the dissemination of technical information or stimulation of production.

31.205-44 Training and educational costs.

(a) *Allowable costs*. Training and educational costs, including training materials and textbooks, are allowable to the extent indicated below.

(b) *Vocational training*. Costs of preparing and maintaining a non-college level program of instruction, including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees are allowable. These costs include (1) salaries or wages of trainees (excluding overtime compensation), (2) salaries of the director of training and staff when the training program is conducted by the contractor, and/or (3) tuition and fees when the training is in an institution not operated by the contractor.

(c) *Part-time college level education*. Allowable costs of part-time college education at an undergraduate or postgraduate level, including that provided at the contractor's own facilities, are limited to—

(1) Fees and tuition charged by the educational institution, or, instead of tuition, instructors' salaries and the related share of indirect cost of the educational institution, to the extent that the sum thereof is not in excess of the tuition that would have been paid to the participating educational institution;

(2) Salaries and related costs of instructors who are employees of the contractor; and

(3) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year where circumstances do not permit the operation of classes or attendance at classes after regular working hours. In unusual cases, the period may be extended (see paragraph (h) below).

(d) *Full-time education*. Costs of tuition, fees (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the contractor's own facilities, at a postgraduate but not undergraduate college level, are allowable only when the course or degree pursued is related to the field in which the employee is working or may reasonably be expected to work and are limited to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

(e) *Specialized programs*. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of managers or to prepare employees for such positions are allowable. Such costs include enrollment fees and related charges and employees' salaries, subsistence, and travel. Costs allowable under this subparagraph do not include costs for courses that are part of a degree-oriented curriculum, which are only allowable pursuant to paragraphs (c) and (d) above.

(f) *Other expenses*. Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable to the extent prescribed in 31.205-11, 31.205-24, and 31.205-36.

(g) *Grants*. Grants to educational or training institutions, including the donation of facilities or other properties, scholarships, and fellowships are considered contributions and are unallowable.

(h) *Advance agreements*. Training and education costs in excess of (1) 156 hours per year per employee for part-time college level training or (2) one academic year for full-time postgraduate studies may be allowed to the extent set forth in an advance agreement negotiated under 31.109. To be considered for an advance agreement, the contractor must demonstrate that the costs are consistently incurred under an established engineering or scientific training and education program and that the course or degree pursued is related to the field in which employees are now working or may reasonably be expected to work.

(i) *Training or education costs for other than bona-fide employees*. Costs of tuition fees, textbooks, and similar or related benefits provided for other than bona-fide employees are unallowable, except that the costs incurred for educating employee dependents (primary and secondary level studies) when the employee is working in a foreign country where public education is not available and where suitable private education is inordinately expensive may be included in overseas differential.

(j) *Employee dependent education plans*. Generally, costs for college plans for bona-fide employee dependents are unallowable.

31.205-45 Transportation costs.

Allowable transportation costs include freight, express, cartage, and postage charges relating to goods purchased, in process, or delivered. When these costs can be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items. When identification with the materials received cannot be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the contractor follows a consistent and equitable procedure. Outbound freight, if reimbursable under the terms of the contract, shall be treated as a direct cost.

31.205-46 Travel costs.

(a) Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable subject to paragraphs (b) through (f) below. These costs may be based upon (1) actual cost incurred, (2) per diem or mileage, or (3) a combination of (1) and (2) provided the method used does not result in an unreasonable charge.

(b) Travel costs incurred in the normal course of overall administration of the business are allowable and shall be treated as indirect costs.

(c) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract under 31.202.

(d) The difference in cost between first-class air accommodations and less-than-first-class air accommodations is unallowable except when less than first-class accommodations are not reasonably available to meet necessary mission requirements (such as when less-than-first-class accommodations would require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, or would offer accommodations not reasonably adequate for the physical or medical needs of the traveler).

(e) Costs of travel via contractor-owned, -leased, and -chartered aircraft are subject to the following:

(1) "Cost of contractor-owned, -leased, and -chartered aircraft," as used in this paragraph, includes the cost of lease, charter, operation (including personnel), maintenance, depreciation, insurance, and other related costs. This cost is allowable, if reasonable, to the extent that the contractor can demonstrate that the use of the aircraft is necessary for the conduct of its business and that the increase in cost, if any, in comparison with alternative means of transportation is commensurate with the advantages gained.

(2) Some of the factors to consider in determining the necessity for such aircraft are whether—

(i) Scheduled commercial airlines or other suitable less costly travel facilities are available at reasonable times, with reasonable frequency and serving the required destinations conveniently;

(ii) It is likely that critical or emergency situations might arise that could not be accommodated as effectively by scheduled commercial airline or other suitable less costly travel facilities;

(iii) The increased flexibility in scheduling would result in time savings and more effective use of key personnel;

(iv) National or industrial security demands privacy for key personnel who must work enroute; and

(v) The contract requires flight testing of equipment.

(3) When the need for contractor-owned, -leased, or -chartered aircraft has been demonstrated, additional factors such as the following shall be considered in determining the reasonableness of costs:

(i) The number, type and size of aircraft needed (involved in this determination are matters such as the number and physical aspects of locations to which flights are required, distances of these locations, number of passengers to be carried, and frequency of flights).

(ii) The appropriateness of the method of acquisition, i.e., purchase, lease, or charter.

(iii) Whether, when the contractor has more than one type or size of aircraft, that available aircraft best suited to the requirements of each individual trip was used.

(4) Where the need for contractor-owned, -leased, or -chartered aircraft has been demonstrated, optimum use of such aircraft, rather than scheduled commercial service, should be made where a cost advantage will result to the Government.

31.205-47 Defense of fraud proceedings.

(a) *Definitions.* "Costs," as used in this subsection, include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; the salaries and wages of employees, officers, and directors; and any of the foregoing costs incurred before commencing the formal judicial or administrative proceedings which bear a direct relationship to the proceedings.

"Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding or prosecution, (2) civil litigation, or (3) suspension, debarment or other administrative proceedings, or any combination of the foregoing, brought by the Government against a contractor, its agent or employee, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud on the part of the contractor, its agent or employee, as defined below, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agent or employees, or decision to debar or suspend, or are resolved by consent or compromise.

(c) In circumstances where the charges of fraud are resolved by consent or compromise, the parties may agree as to the extent of allowability of such costs as a part of such resolution.

(d) Costs which may be unallowable under 31.205-47 shall be differentiated and accounted for by the contractor so as to be separately identifiable. During the pendency of any proceeding or investigation covered by paragraph (b) above, the contracting officer should generally withhold payment of such costs. However, the contracting officer may in appropriate circumstances provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreement by the contractor to repay all unallowable costs, plus interest, if a conviction or judgment is rendered against it.

31.205-48 Deferred research and development costs.

"Research and development," as used in this subsection, means the type of technical effort which is described in 31.205-18 but which is sponsored by, or required in performance of, a contract or grant. Research and development costs (including amounts capitalized) that were incurred before the award of a particular contract are unallowable except when allowable as precontract costs. In addition, when costs are incurred in excess of either the price of a contract or amount of a grant for research and development effort, such excess may not be allocated as a cost to any other Government contract.

Mr. ADAMS. In our review we didn't find that access to the data necessary to settle overhead accounts was particularly restricted. What I may have alluded to at some time is the fact that in the access to data, by contract provision, costs on fixed-price contracts are not made available routinely to the DCAA auditors, because of the nature of their being firm fixed-price contracts. The only costs made available on a regular basis are on fixed-price incentive and cost-type contracts. And to that degree, there is a limitation on access.

Mr. SIKORSKI. You have never audited the overhead claims of defense contractors in order to determine whether the DCAA is, in fact, finding most or all of the unallowable charges; isn't that correct?

Mr. CONAHAN. That's correct. We are relying on the DCAA work here.

Mr. SIKORSKI. My sense is, from talking with the DCAA people or listening to them, is that, it's a David-and-Goliath without David winning.

Mr. CONAHAN. DCAA has considerable problems, and we have noted those problems.

Mr. SIKORSKI. I would hope that you would be reviewing those charges firsthand, and then compare what you come up with in terms of unallowable charges and what the DCAA people come up with in unallowable charges and then the analysis that you took as to what happens. Then, when the contracting officers and the others get in there and start negotiating the final settlements, they have the necessary documentation.

Mr. CONAHAN. I would have to say, Mr. Sikorski, that that would be a very difficult task, let's say, a high resource burden that you are suggesting. The responsibility for that work in the first instance is DCAA's. I think that we might be better off if we did do a little further work in terms of seeing what sort of access DCAA does get, what problems they are experiencing.

But to go in and do the actual audit itself, it seems to me, would be bumping against DCAA's responsibility.

Mr. SIKORSKI. Well, you know, you're bumping against the contracting officers' responsibilities in here. The question is, whose responsibility you are bumping into.

Your responsibility is, as an arm of Congress, to get in there and do that work. I suspect that you can do a case study or a couple case studies.

Mr. CONAHAN. We can do it on a case-study basis; yes, sir.

Mr. SIKORSKI. Maybe you misunderstood me. I didn't mean you should go in and take over that responsibility, and I'm sure the chairman is going to ask you to do just that. So we can compare apples and oranges at the very beginning and follow the procedure through.

You testified to DOD or provided DOD with your results last summer; is that correct?

Mr. CONAHAN. We testified in July before the House Government Operations Committee on this matter with respect to public relations costs. We talked about such things as advertising and selling costs. And then in October we made a report to the Secretary of

Defense, October 29, and in it, we made recommendations to clarify the FAR criteria.

Mr. **Sikorski**. And what have they done on the basis of your testimony?

Mr. **Conahan**. They have drafted revisions to the FAR to make the clarifications that we had recommended.

Mr. **Sikorski**. They have drafted them?

Mr. **Conahan**. They have drafted them, and they have circulated them for comment.

Mr. **Sikorski**. Who did they circulate them to?

Mr. **Conahan**. Well, they circulated them to us. I would expect that they had been circulated to——

Mr. **Sikorski**. The defense contractors?

Mr. **Conahan**. Yes, to the defense contractors, I am sure of that, and to the other members of the defense procurement community.

Mr. **Wyden**. Would the gentleman yield?

Is that a common practice? Do we circulate these proposals to the contractors?

Mr. **Adams**. Yes; it is. They have a very special practice of disseminating these proposed FAR amendments on the widest possible basis. They try to get everybody's comments. Yes; industry very definitely, as well as all Government agencies. Their practice is to try to get as many views as they can.

Mr. **Sikorski**. I think everyone affected has the right to make a comment on these. But that process is guaranteed in the promulgation process later on, as well.

My concern is with the time, the time it takes. We're going to hear later testimony from other people about these time limits. All of a sudden there's a problem, and then they start working on it, and it's like hatching a golden egg. It takes a long time and usually doesn't crack.

We have heard stories, Mr. Adams, about McDonnell Douglas billing the Government, billing the Government for $50 million in legal fees for a lawsuit against another defense contractor. Does the DAR allow such costs, billable costs?

Mr. **Adams**. Legal costs are clearly an allowable item of cost under DAR or under the now FAR, as long as they are reasonable and are for a purpose that is considered reasonable by——

Mr. **Sikorski**. Well, the question is, what purpose is served, interest, in suing another defense contractor, over——

Mr. **Adams**. It is a cost of doing business that under the view of many reasonable people is a normal cost of doing business.

Mr. **Sikorski**. What is the advantage to the taxpayers of the United States of America? It's a profits issue, isn't it?

Mr. **Adams**. Yes. And I suspect that they could make the case that just staying in business and producing a good product is of benefit to the——

Mr. **Sikorski**. I suggest that the DAR set a set rate for legal fees, and there is no sense that the DCAA people have to have low paid or nonexistent legal services at the same time that the defense people are negotiating with them to bring in the highest priced lawyers they can find at the greatest amount. Some of them are probably in this room right now. And they charge that back to the taxpayers who are being served by the other side, not by them.

One question. We heard on March 12 the Secretary of Defense take an unusual step and issue a certificate that corporate officials must sign under penalty of perjury that all costs included in their claims are true. You know, it was a major step forward, that people are not going to lie when they bill the Government. Ninety-five million Americans filed their tax returns by last Monday, and they had to swear that they were done truthfully. To buy a dog license or a fishing license in Minnesota, you have to swear that you're telling the truth.

What do you think of this approach?

Mr. **Conahan**. I think it might have been more symbolic than anything else.

Mr. **Sikorski**. Apparently.

Mr. **Conahan**. It's my understanding, and I believe I'm correct on this, that a provision of law, 18 U.S.C. 1001, requires a provision in each contract that holds the contractor to not submitting false claims in the first instance. So I'm not really sure that another certification was necessary.

Mr. **Sikorski**. Well, evidently they backed off of it already. First, they announced they aren't going to do anything criminally on it, and second, they announced that it is really final settlement time that you only have to certify.

So after everything has been pushed into this pipe, the stuff that may get caught by the auditor and that may finally get negotiated with the contracting officer then gets put down onto paper. After all the lawyers have come in, is the stuff that the person signs truthful? There is no incentive to be truthful in the front end.

Mr. **Conahan**. I agree with your analysis, sir. And as a matter of fact, the settlements that we're talking about here are the final settlements, and these things are finding their way into the final costs.

Mr. **Sikorski**. Well, Mr. Adams, that certainly is a backing off of the announcement made by Mr. Weinberger on March 12, is it not?

Mr. **Adams**. The certificate, as I understand it, was an attempt to make the contractors be very aware that the costs they were submitting, regardless of what the billings were for, were not including unallowable costs. They made what I think was a tactical error in describing in paragraph 4 of the certificate—and if I can find their certificate—they tried to describe 19 cost accounting standards in that one paragraph. This is just absolutely impossible. And as a consequence, they really gave industry a real problem, because they could not certify to what was asked of them. Paragraph 4 of the certificate reads: "All cost included in this claim benefit the Department of Defense and are demonstrably related to or necessary for the performance of the Department of Defense contract covered by this claim."

And the fact is, there is no way a contractor could——

Mr. **Sikorski**. Well, how many people are there over at the Department of Defense, how many thousands of people in Department of Defense?

Mr. **Adams**. I don't know. A lot.

Mr. **Sikorski**. A lot. And how many billions of dollars do they deal with? Approximately $300 billion. They can't write a simple paragraph to the Secretary of Defense describing a simple statement that defense contractors have to swear to when they bill the taxpayers for billions of dollars.

And that perhaps best illustrates the problems we have. People either whose competence is in question or their unwillingness to make sure that the taxpayers don't get billed is displayed.

The truth of the matter is, Weinberger announces a big get-tough policy on nationwide TV, in front of the VFW, and said that for the first time, people who do business with the Defense Department are going to have to swear that they are not stealing when they bill the taxpayers.

Then they announce, "Oh, don't worry. We're not going to provide any criminal penalties for this." And now they're saying, "We're only going to do it at final settlement."

That is a backing-off, is it not?

Mr. **Adams**. It certainly is changing their position and certainly backing away from the original——

Mr. **Wyden**. Would the gentleman yield?

Mr. **Sikorski**. Yes.

Mr. **Wyden**. I appreciate it.

Don't the changes gut the original proposal? They take all the teeth out of the original proposal.

Mr. **Adams**. The original proposal being the original rewrite of the certificate?

Mr. **Wyden**. That's correct. Are there any teeth left? What teeth are left?

Mr. **Adams**. In my estimation, the teeth are there that were there before.

Mr. **Sikorski**. 18 U.S.C. 1001?

Mr. **Adams**. More than just that. It's all the regulations, including the cost-accounting standards, that tell contractors how to allocate these costs, what the beneficial or causal relationships are between these costs and a contract. The FAR regulations that tell you what costs will be allowable and not allowable. And that's all the certificate ever should have said.

Mr. **Sikorski**. Ending the capacities of those teeth. You have those teeth. We have an aberration in the Secretary's mind. General Dynamics comes in downstairs and admits the problems they have had and the money that has been taken improperly. And then the Secretary announces a new get-tough policy and a certification process that's going to change all this.

Then subsequent to that very public announcement are these retreats back to the original teeth that aren't closing; isn't that correct?

Mr. **Adams**. I would have to say yes. I agree with that.

Mr. **Conahan**. At the same time, I think we must add that the initial body of regulation hasn't changed. And something has to be done in that regard. So I don't think it's quite as simple as the statement of certification. We have to take care of some of these underlying things.

Mr. **Sikorski**. Absolutely. I am not embracing the certification as the end-all and be-all of reforms. In fact, it's just one of those little pieces that Mr. Adams was talking about in his analogy.

But that big PR announcement has been gutted, and I think it is important to put that in the record.

Thank you, Mr. Chairman.

Mr. WYDEN. I thank the gentleman. I think the gentleman has made an excellent point. With the massive staff of lawyers, I still don't see why the rules couldn't have been written logically and properly in the first place. And clearly, that is a major part of the problem.

The gentleman from New Jersey.

Mr. FLORIO. Thank you, Mr. Chairman.

I thank the gentlemen for their testimony. I have two areas that I'd like to go into a bit.

Quite frankly, I came to get some guidance and some help from you to try to understand some very fundamental things that I don't understand as a result of having read through the materials.

Admittedly, my background in Government procurement is very unsophisticated. I was a municipal lawyer in a couple of towns, and I reviewed contracts when rock salt was purchased or police cars or things of that sort.

But coming from that unsophisticated perspective, I don't understand how we are talking about a fundamental system that allows the transferral onto the taxpayers of certain costs. I mean, if we ever tried to allow the costs for the purchase of a fleet of automobiles on the basis of sales promotions of the contractor, or entertainment costs for the employment morale of the contractor's employees, or meeting to disseminate information industrywide for those contractors, at worst someone would go to jail. At best, everybody would be thrown out of office in the next election for squandering the taxpayers money.

How have we gotten to the point that we are considering in the purchase of contracts these types of things? If you have changes, there are change orders, and they are reviewed. But these types of things as part of a contract, how is it that we have gotten to this point?

I mean, it certainly is not contracting procedure at other levels of Government. How has this all grown up that we are allowing these types of things?

Mr. CONAHAN. Contracting regulations, of course, have been in effect for as long as the Government has had contracts, and therefore we have had a certain evolution take place here. There is continual modification and change to these regulations. There are bodies in place within the Government—for example, we have the Defense Acquisition Regulatory Council; we have a Civil Agency Acquisition Council—both of which are charged with the responsibility of monitoring these particular regulations.

These regulations, as they exist today, came out of that continuing process over a period of time.

Mr. FLORIO. Let me reduce it to a very unsophisticated level again. The idea that we are buying whatever, two dozen widgets, and the cost of them is *x*, how has it evolved that costs for the morale of the employees of the Widget Manufacturing Co. is somehow factored into the purchase price?

Mr. CONAHAN. I can only state that the Federal acquisition regulation has a cost category covering employee morale, and it gives certain parameters on what can be charged, but nonetheless, it provides for charging those kinds of costs to Government contractors.

Mr. **Florio**. Well, what you are telling me is, we have done it this way, it has evolved this way, and therefore employee morale is a legitimate cost of the contract.

Mr. **Conahan**. That's correct.

Mr. **Florio**. There is nothing wrong prospectively, is there, with writing contracts specifically excluding any of these points? Can we write a contract that we are purchasing 27 whatevers, and we are going to exclude payments for employee morale of the contracting company?

Mr. **Adams**. You started your first question by talking about purchasing automobiles or purchasing something that is what I will describe as a marketplace procurement. The fact of the matter is, there are many people that make automobiles, and there are many, many more people who buy automobiles, and therefore the price of that automobile is a marketplace-established price.

In the case of the Government, we have a very unique situation. We are a monopsony. We are a one-buyer——

Mr. **Florio**. Well, local government is government, too.

Mr. **Adams**. I understand that. But nonetheless, to the degree that you have one buyer, that dominates a procurement, regardless of how many sellers you have. You have a monopsony.

Once you have that situation, you can no longer rely on a true marketplace to set the price such as you have with automobiles. The price that gets paid for any given unit you buy now has to rely not on price but on cost. Once you establish the fact that you are going to base most of your procurement on cost—and incidentally, the people who make automobiles don't even bother to allocate much of the costs that are in their operation. They don't allocate the G and A; that is the President's salary, the lawyers' salaries. They don't even care how much of that goes to each individual automobile or any group of automobiles.

That is not so in defense procurement. In defense procurement, it's extremely important that you know where those costs go, and that is why we spent 10 years writing cost-accounting standards, which were the first real body of work establishing how costs would be allocated to final cost objectives.

How would the president of General Dynamics costs finally be relayed down to a final cost objective, an F-16, if you will, or whatever?

I come to this only to say that in that cascade of costs are costs of doing of business, such as employee morale, such as entertainment, such as interest, such as consultants' costs.

In the determination of the procurement of items based on cost, we determine what are those costs we want to pay and what we don't want to pay. The cost-accounting standards tell how all those costs are allocated. The procurement people then say, "We choose not to pay interest," so they write a regulation which says, "Interest will not be allowable."

On the other hand, they say it is important that they have places for their employees to have recreational facilities or a gymnasium——

Mr. **Florio**. I understand what you're saying. But because you raised my second point in your last comment, as to what you choose to pay and what you choose not to pay, there is no penalty, is there, associated with a cost being disallowed, so there is a payment being made for a cost that ultimately could be disallowed? I mean, you effectively have almost an interest-free loan situation when a cost is ultimately disallowed. And inasmuch as you are not auditing everything, some people are falling through the cracks, so that you are sort of encouraging somebody to throw everything up against the wall in the hope that something sticks, and if it doesn't stick, no big deal; they've got an interest-free loan. There's no self-discipline imposed on anybody to make sure that they comply with the very nebulous considerations of what is employee morale and what is a thrill.

I notice that you made some suggestions for improvements, but you didn't say anything about penalties or some sanction for having costs disallowed. Don't you think that would be something that would be a very good self-disciplining mechanism, if we had some price that someone had to pay for making these wrong decisions?

Mr. ADAMS. It clearly would be motivational. It clearly would be motivational.

When I said that I believe you need to take this a step at a time, rather than trying to eat the beast all at one time, requiring a repayment of money with interest may be such a step. It's certainly a step that the General Accounting Office is not ready to recommend today. We just haven't studied enough on it to do that.

Mr. FLORIO. Well, what is there to study?

Mr. ADAMS. Well, I would think that there are—it's a very sophisticated world that we live in out there in this procurement world, and it takes a great deal of study before you decide to make——

Mr. FLORIO. Well, isn't that half the problem we're having? I mean, we're saying it's a sophisticated world. We've had some very unsophisticated examples presented to us over the last couple of weeks. And I don't know if we really can afford to keep saying that we're going to have to study fundamental things like the Government's overcharge. Somebody is getting a benefit out of the overcharging, and now we're finding that this is not just an isolated event. Apparently, it is fairly prevalent.

I don't think that——

Mr. WYDEN. Would the gentleman yield?

Mr. FLORIO. Certainly.

Mr. WYDEN. I appreciate it.

Mr. Adams, have any of the contracting officers been punished when they gave away the store?

Mr. ADAMS. Oh, I am sure that you would not find the declaration by any of them that they had given away the store, so I'm sure not.

Mr. WYDEN. How about Mr. Modesitt, where millions of dollars of the taxpayers money was given away without documentation? Has anybody been punished for doing that?

Mr. ADAMS. I couldn't even characterize that that way, Congressman Wyden.

Mr. WYDEN. But you agreed that that is what we were told yesterday, didn't you? I mean, he said that was the case.

Mr. ADAMS. I believe that the system that we have set up, if you go get the documentation that Mr. Modesitt signed off on and that got signed off by various people, you will not find anything that will——

Mr. WYDEN. There was nothing signed off on, Mr. Adams. That was the point of yesterday.

Mr. ADAMS. Well, I couldn't really comment beyond that, because I haven't looked at his documentation.

Mr. WYDEN. It's the gentleman's time.

Mr. FLORIO. Yes. The point the gentleman has made is one that obviously people could disagree with, but what people can't disagree on is, if you have a decision made that a cost that shouldn't have been accepted is now being disallowed, and someone had the benefit of the Government's money for a long period of time, why shouldn't they at least be required to pay back, and then maybe something on top of that?

I mean, I don't think that's——

Mr. CONAHAN. Well, No.1, I quite agree that the contractor has had the Government's money for its benefit for whatever period of time is involved.

Our prescription here is simply that you write the rules in such a way that the contractor cannot, in the first instance, get that money for its use and have it over a period of time and then later disallow it.

As I said, last fall, we recommended that the Secretary of Defense direct changes in the FAR with respect to advertising and public relations costs.

Mr. FLORIO. Let's assume that your suggestion is a good one. But I mean, you haven't got that much confidence in the whole system being that radically changed, so that everybody is going to now be on the straight and narrow.

Mr. CONAHAN. I would hope so, and I think we have to peck away at it. But let me give you an example.

Mr. WYDEN. Excuse me. If I might, Mr. Conahan, how long do we have to peck away at it?

We have been told that they have been trying for 10 years to get a change in the regulations on corporate aircraft. And what do you define as "pecking away?"

Mr. CONAHAN. I think you make a good point, sir. I think you make a good point.

What I'm trying to do here is to say that one of the items of costs that we found was very high was the cost of air shows that were being charged to these contracts. And we suggested that the regulations be written in such a way so that they would not be allowable.

And the current proposal reads as follows: "Unallowable public relations and advertising costs include the following: (3) cost of air shows and other special events such as" and it mentions a number of things, and it goes on to point out at the end that, "Costs made specifically unallowable under this subsection are not made allowable under the other subsections." So there is no ambiguity there.

Mr. FLORIO. I come back to my point that, what is the harm or why is it in any way inequitable to, as soon as is possible start charging at least interest for the monies that would ultimately—or the charges that would ultimately be disallowed? Why not make all those changes, and hopefully everything will be totally clear? No ambiguities.

But let's assume that something is ambiguous and ultimately it is disallowed. Do you have any problems conceptually with the idea of at least interest payments or some sort of a penalty to induce the contractors to make the hard decision as to whether it is or is not, and if it's not, then they know they pay a price for it?

Mr. ADAMS. Let me respond. The climate that you are manifesting was there in 1969 and 1970 when the Cost Accounting Standards Board was established. And let me just say—and it comes to your point, Mr. Florio—that there is a provision now for interest payments on these costs that are overpaid.

It comes about that in Public Law 91-379, that if there is a noncompliance with a cost accounting standard, and if that noncompliance costs the Government money that it would not otherwise be required to pay, that money will be paid back with the magnificent sum of 7-percent interest, which at that time was a suitable interest rate.

Mr. FLORIO. All of the examples that we've heard over the last month or two, General Dynamics, apparently Pratt Whitney, are they all capable of being reimbursed under this proposal?

Mr. ADAMS. They are not.

Mr. FLORIO. Why?

Mr. ADAMS. Because under the way the current regulations are written, there has not been the ability to determine that those costs are, quote, "expressly unallowable" or they have not been mutually agreed to between the contractor and the Contracting Officer, on being mutually——

Mr. FLORIO. Well, what you're really saying is if that sanction doesn't apply to what appears to be obvious abuses, is it really not too terribly much of a sanction?

Mr. ADAMS. Well, what I'm trying to say is that the recommendations we have made here today to clarify the DAR or the FAR should take one step in making those costs expressly unallowable, and therefore subject to CAS 405, and therefore subject to the interest repayment.

And second, once you require the parties to negotiate and settle, element by element, you then have the second leg that says that those costs also should be set aside, then subject to 405 and to the interest payment, and you could at least start toward the recoup.

Mr. WYDEN. The time of the gentleman has expired.

The gentleman from Texas.

Mr. BRYANT. Thank you, Mr. Chairman.

Mr. Conahan and Mr. Adams, I wasn't ever clear on why you were unable to deal in more concrete terms with Mr. Modesitt's reaction to us yesterday when we expressed some—I think outrage is the right term—about the fact he had settled out these claims with General Dynamics without having any kind of written justification of how he did it, what formula he used. In particular, with regard to travel expenses, he didn't even have the logs to show who went on the airplane. He just took their word for it.

Additionally, he told us that there never was any final judgment rendered on each individual claim, that instead what he did was to take all the claims together and then give them a percentage of all the claims, so that he didn't disallow them one by one or allow them one by one.

I don't understand why that situation exists, (a), and I would like you to answer that, and (b), I don't understand why a person who did what Mr. Modesitt did, which apparently—I shouldn't single him out—apparently it's quite common—is not fired?

Mr. **Conahan**. I think that we are in a position to say that that condition is prevalent. We found it throughout the contractor activities that we reviewed—one, that the costs are settled on a total basis and not on an item by item basis. Therefore, we do not establish precedent for getting these things out, and contractors then can come in year after year and bill the Government for these same kinds of costs.

Second, we did find inadequacies in documentation both before we went into the negotiations, as well as to what happened during those negotiations, and there is not a track record then so as to find out precisely what happened.

Insofar as the attempt or motivations of people, I'm not sure that we can comment on that. And secondly, I don't think that I can really comment on what the response to that kind of performance should be.

Certainly, if it is judged to be deficient, it should be so noted. And there are administrative remedies within any organization to take care of performance. But I'm not sure that I can comment on that.

Mr. **Bryant**. Well, the question a moment ago that was asked that you didn't feel good about answering, I guess, either, was, has anybody ever been disciplined or sanctioned or has a note been put in their file or have they been dismissed for doing such a poor job of settling out claims against the Government?

Mr. **Conahan**. I can't really comment on that, except to say that we have not looked at it, so I can't say.

Mr. **Bryant**. You mean you don't know?

Mr. **Conahan**. I don't know.

Mr. **Adams**. Nor I.

Mr. **Bryant**. Do you consider it important to find out, and wouldn't it be significant? If there is no sanction against you for doing a bad job, then why wouldn't that be important?

Mr. **Conahan**. I think it is something that maybe we can take a look at. We have not done it yet.

Mr. **Bryant**. I'm not suggesting——

Mr. **Adams**. Let me say that the majority of cases we looked at, there was enough question—and we did not look at specifics at what the witness said yesterday, or any of his negotiations—but of the ones we did look at, there were enough questions and vagueness in the FAR that it would be very difficult for me to take a Contracting Officer and say, "I think you should be sanctioned, based on what I have seen in this writeup."

Most of these people are rational and reasonable people, and basically they are at a modest level in terms of—in the Government pay structure, and therefore it would be difficult for me to say that they were derelict in what they did or——

Mr. **Bryant**. No, I agree. I wish to conduct an inquisition of people like that. I agree exactly with your characterization of them. I think they probably are very responsible people as well. But we have to find some way to compete with the ethic or the system of values that exists there which says, "The way you get ahead in this business is if you don't rock the boat." And the only way to compete with that that I know of is to say, "If you do a bad job, you are going to be professionally damaged for doing so. You're not going to get a promotion; you're going to get a demotion, or maybe you're going to get fired."

It seems logical to me. I'm surprised you don't have a strong opinion about that.

Mr. CONAHAN. Well, I think, again, that becomes pretty subjective.

As Mr. Adams pointed out, it is difficult to objectively conclude in many of these cases that the Contracting Officer should have gone this way versus that way. Because of the ambiguity that does exist in the regulations that govern his actions, he frequently is not in a position to tie these things down.

Mr. BRYANT. Well, I assume, and correct me if I'm wrong, isn't there some requirement that you put in writing, a justification of how you settled the matter out?

Mr. CONAHAN. Yes, sir. I quite agree.

Mr. BRYANT. In the case yesterday, there was nothing in writing.

Mr. CONAHAN. And we found that similar situations existed in other contracting activities.

Mr. BRYANT. What do we do about that?

Mr. ADAMS. We have already written to the Department of Defense in one case saying that we believe that the documentation should be written better, that the Contracting Officer should write them better. And I would imagine that as a result of our meeting here in which we have made some additional steps that we are going to suggest, we will again recommend that they—well, we're going much further. If we follow through with our recommendation that these cost items be negotiated and settled on an individual basis, then they are going to have to be written up. They are going to have to be written up as to what the results of each category of cost is.

It's not just a case of putting them in a pot and saying, "Let's split it down the middle," and then giving it to your aide to say, "Plug in where these numbers should go."

Mr. BRYANT. When did you write the Defense Department with that recommendation? You just mentioned that you had already written them, and you thought you might write them again. When did you write to them?

Mr. CONAHAN. October 29, 1984.

Mr. BRYANT. 1984? Can you just tell me briefly what the letter said? You don't have to read the whole letter; I have it here, but summarize what the point of it was.

Mr. CONAHAN. We talked about the ambiguity of the FAR criteria and the fact that, because of that, a lot of costs questioned by DCAA were getting allowed into overhead, and that the procedure being used was this bottomline negotiation between the contractor and the ACO's. And then we made recommendations, and we recommended that the Secretary of Defense direct the Defense Acquisition Regulatory Council to work with the civil side of Government to clarify the FAR criteria for the cost categories of advertising and selling to reduce the ambiguities surrounding these costs, and to specifically address in FAR the circumstances under which a number of cost items would be considered allowable or unallowable.

Mr. Bryant. Now this letter only relates to public relations expense; is that correct?

Mr. Conahan. Yes, sir.

Mr. Bryant. Well, what about all the rest of them?

Mr. Conahan. Well, that's the subject of our testimony here today.

Mr. Bryant. But you have made no recommendation or have not made a recommendation heretofore?

Mr. Conahan. Not heretofore; no, sir. We will, on the basis of this testimony.

Mr. Bryant. OK. Well, first of all, I don't quite understand why that couldn't have been done at the same time you did this. But with regard to public relations only, what has been the response of the Defense Department?

Mr. Conahan. The Defense Department—well, actually the FAR Secretary at GSA has drafted revised regulations and is circulating those regulations for comment.

Mr. Adams. They acted quite swiftly for the system that we have in place. I was surprised that we got a suggested FAR revision as quickly as we did.

Mr. Bryant. Well, when did you get it?

Mr. Conahan. They circulated it at the end of February.

Mr. Bryant. In other words, you wrote a recommendation in October. So they circulated it in February. Now this is April 24th, I think. Is it working? Is it in place?

Mr. Conahan. It is not in place.

Mr. Bryant. Well, how can that be considered quick?

Mr. Adams. I prefaced my remark by saying, "the system we have." It's a big, complex system, and these things take a lot of time.

Mr. Dingell. Would the gentleman yield?

I am curious. You've got a big, complex system. But why is the act of approving your suggestion, changing the regulations, more complex in a large system than in a small system, and why can't it be expeditiously done?

Mr. Conahan. I don't think that we would suggest that it is any more difficult in a larger than in a smaller. I think we simply have to make the statement, Mr. Chairman, that we made the recommendation on October 29th. A couple of months later, they came out with a proposed modification, and it is now going through the comment period.

Mr. Dingell. What was the comment period?

Mr. Conahan. I don't have that as to precisely what that comment period is.

Mr. Dingell. Well, from October to April is 6 months, give or take a little.

Mr. Conahan. Yes, sir. It was circulated toward the end of February, but I don't have what the comment period is.

Mr. Dingell. I thank the gentleman for yielding.

Mr. Bryant. Mr. Conahan or Mr. Adams, I have a copy of a letter here that has been obtained by the staff of the subcommittee, which is headed "Subject: Documentation for Negotiated Settlement of Indirect Costs Charged to the Government Contracts at General Dynamics." It is signed by a man named Robert M. Gilroy, Senior Associate Director.

Do you know who he is?

Mr. Conahan. Yes, sir. He was formerly an associate director in our Washington office. He is now in our office in Honolulu.

Mr. Bryant. You say your Washington office. Which Washington office of what?

Mr. Conahan. He worked in my organization until he went to Honolulu last summer.

Mr. Bryant. That is the National Security and International Affairs Division of the GAO?

Mr. Conahan. Yes, sir. Before that, he was in an organization called Procurement Logistics and Readiness Division.

Mr. Bryant. I don't know how to handle this, except to read most of this letter to you. It says, "The purpose of this letter is to bring to your attention"—by the way, it's addressed to John Lehman, Secretary of the Navy—"The purpose of this letter is to bring to your attention the lack of documentation for negotiation decisions for costs incurred at the General Dynamics Corporate Office, St. Louis, MO."

And I will skip a paragraph and read:

> In April 1981, the Corporate Administrative Contracting Officer, Headquarters, Naval Materiel Command, Washington, D.C. negotiated and incurred expenses for the General Dynamics Corporate Office for calendar year 1977. The DCAA questioned the reasonableness, allowability, or allocability of about $4.5 million of the proposed $23 million cost, and negotiations with the Contractor resulted in disallowance of only $1.5 million of the questioned costs.
>
> The CACO prepared a document showing the costs allowed or disallowed, however, this document did not show the basis for allowing or disallowing the costs questioned by DCAA.

[The following documents were submitted:]

UNITED STATES GOVERNMENT
Memorandum

GENERAL ACCOUNTING OFFICE

January 21, 1983

Dw

TO : Group Director, PLRD/GP - Clark G. Adams

E Hyde

FROM : Senior Evaluator, KCRO (St. Louis) - Edward Hyde

SUBJECT: Letter Report on Documentation for Negotiated Settlement of Indirect Costs Charged to Government Contracts at General Dynamics (Code 942090)

In accordance with our agreement at the midpoint conference, we are forwarding the attached draft of a letter report on the lack of Navy documentation to support the negotiation decisions for indirect costs at General Dynamics corporate office. The report has been referenced in accordance with Chapter 7 of the Report Manual. The workpapers supporting this letter will be retained in St. Louis.

If we can be of further assistance please call me at FTS 279-4121.

cc: RM, KCRO - D.A. Hanna - w/attachment

January 24, 1983

Subsequent to mailing the above draft, we decided the deletion of one paragraph would improve the readability of the draft. Therefore, we are enclosing a revised copy.

The Honorable John Lehman
The Secretary of the Navy

Dear Mr. Secretary:

Subject: Documentation for Negotiated Settlement of Indirect Costs Charged to Government Contracts at General Dynamics

The purpose of this letter is to bring to your attention the lack of documentation to support negotiation decisions for costs incurred at the General Dynamics corporate office, St. Louis, Missouri.

We are currently performing a review of selected contractor activities to evaluate the procedures and practices employed by the Department of Defense (DOD) to prevent unallowable costs being allocated to Government contracts. This review is directed towards evaluating the Defense Contract Audit Agency's (DCAA) review of contractor incurred indirect costs and the use made of their audit determinations during negotiation of overhead rates for final pricing of Government contracts.

In April 1981, the Corporate Administrative Contracting Officer (CACO), Headquarters, Naval Material Command, Washington, D.C., negotiated the incurred expenses for the General Dynamics corporate office for calendar year 1977. The DCAA questioned the reasonableness, allowability, or allocability of $4,599,215 of the proposed $23,936,871 costs. The negotiations with the contractor resulted in disallowance of only $1,500,000 of the questioned costs. The CACO prepared a document showing the costs disallowed. However, this document did not show the basis for allowing or disallowing the costs questioned by DCAA.

DAR 3-705(b)(5), dated August 1, 1978, states that upon completion of negotiations, the contracting officer will prepare a negotiation memorandum which

> "will address: (i) disposition of significant matters in the audit report, (ii) resolution of questioned costs, and (iii) identification of cost or pricing data submitted during negotiation and relied upon in reaching a settlement."

The CACO allowed $3,099,215 of the costs questioned by the DCAA but we were unable to locate, nor could Headquarters, Naval Material Command officials locate, a negotiation memorandum or any documentation in the Navy files which explained the resolution of the questioned costs. Naval Material Command officials agreed the DAR required the preparation of a negotiation memorandum documenting the basis of decisions reached through the negotiation process. However, they could not determine why a memorandum had not been prepared.

We believe complete documentation is essential for a structured approach to the negotiation process and effective overview of negotiations. Therefore, we recommend that you initiate action to ensure that DAR is followed in all cases in order to provide necessary documentation for effective overview and control of the negotiation process as well as providing information to the DCAA for use in subsequent audits.

Sincerely yours,

Robert M. Gilroy
Senior Associate Director

Mr. Bryant. My question to you is—there is more to the letter—was this letter by Mr. Gilroy ever sent to John Lehman?

Mr. Conahan. I can't comment on that. Is there a date on it?

Mr. Bryant. There is no date at the top of the letter, which makes me think maybe it never was sent. The letter was not signed either.

Mr. Conahan. I can't answer that question at the moment, sir. I will get an answer for you.

Mr. Adams. I am somewhat familiar with the letter. No, I think it was never sent.

Mr. Bryant. All right. It refers directly to the case of Mr. Modesitt and to what appears to be the very poor job he did on behalf of the taxpayers with regard to settling these claims out.

Why wasn't this letter ever sent?

Mr. Adams. I'm not sure. And I am somewhat familiar with it. I'm sure that draft you see there was prepared during the work we were doing on this current job. We had become aware that they had no CACO at the General Dynamics plant, and we were trying to decide whether or not we should write an interim letter to the Department of Defense or not. And I'm sure that draft was prepared at that time, and I must confess that why we didn't send it—and I'm pretty sure we did not send it—I think it was decided that we would hold it until the report went out.

Mr. Bryant. Well, was anything like it ever sent?

Mr. Adams. No, I think not.

Mr. Bryant. Well, I can't understand that. Do you have an explanation for why you would not have sent a letter like this? It complains about exactly what we heard yesterday, in advance of what we heard.

Mr. Adams. Only in the sense that we were going to build it into the basic report, would be the only reason we would stop it.

Mr. Bryant. Was the report ever issued?

Mr. Adams. In the sense that we reported after our testimony to Mr. Brooks, yes. The essence of our report was issued, yes.

Mr. Bryant. But the draft report was never issued; is that correct?

Mr. Conahan. This report? [indicating].

Mr. Bryant. The report he referred to, which was to contain the contents of this letter which was never sent, and was never sent because you were going to make the report?

Mr. Conahan. OK. I think that the testimony given before Chairman Brooks last summer pulled from that body of work the essence of the points that we were trying to make, which had to do with the ambiguity and the need to tighten up on the FAR.

The examples that we had relating to entertainment and travel, which we talked about here today, did not get reported. But the problem as we saw it, the fundamental problem, we felt got reported.

Mr. Bryant. You mean you reported it orally to a hearing here?

Mr. Conahan. And subsequently to the Secretary of Defense in this letter here [indicating]. This is the October 29th letter.

Mr. Bryant. Reporting what?

Mr. Conahan. Reporting that we found the need to clarify——

Mr. Bryant. Well, that's the letter we talked about a moment ago. That only relates to public relations.

Mr. Conahan. That's right. Yes, it does only relate to that.

Mr. Bryant. But Mr. Modesitt's did not relate only to public relations. It related to a whole range of things.

Mr. Conahan. Including the kinds of things we were talking about here today.

Mr. Bryant. Yes, it did. But it included a great deal more than public relations. What about this draft of a proposed report entitled "Failure of defense negotiators to sustain their contract auditors' advice in overhead negotiations have significant impact on defense contract costs?"

Mr. Conahan. That is the document that initially captured the body of work that we did. That's what we are discussing at the moment.

Mr. Bryant. Was this ever issued?

Mr. Conahan. Not as such. That's the one that resulted in, first, the testimony, then the report to the Secretary of Defense, and now, in large measure, the basis for the testimony that we prepared for today.

Mr. Bryant. But this draft was prepared apparently to refer directly to their failure to handle this problem, the auditors' failures to handle the problem we are discussing today, correctly.

Mr. Conahan. Not the auditors; no, sir.

Mr. Bryant. I'm sorry. The defense negotiators. Failure of defense negotiators to sustain their contract auditors' advice. That was the title of this.

Mr. Conahan. Well, that's the title of that, but that was a very early document put together by the staff, which upon review we felt mischaracterized what the fundamental problem was. We felt that the fundamental problem was the ambiguity in the FAR, and we still believe that that's the problem.

Mr. Bryant. Your answer to me a moment ago with regard to whether or not this draft was ever issued was, I think—well, you reported to Mr. Brooks' committee, and you wrote a letter to the Defense Department about public relations cost. That's about the sum total of what you extracted from this draft; is that correct?

Mr. Conahan. At that point, yes, sir. And then we took it further for today's hearings.

Mr. Bryant. Was the Brooks testimony only on PR also?

Mr. Conahan. Yes, sir. You see PR is not a cost category in the FAR. That kind of lumps a number of things together. And what we included in there were selling costs, advertising, exhibits, giveaways. There were a number of things that we included under the umbrella term of "public relations" that did not exist by that name at that time.

Mr. Bryant. Mr. Chairman, thank you. I am through.

Mr. Dingell. The Chair thanks the gentleman.

The gentleman from Oregon.

Mr. Wyden. Thank you, Mr. Chairman.

I want to follow up on the questions, the very valuable questions asked by the gentleman from Texas.

The subcommittee's staff has recently reviewed the results of the GAO matter we are talking about, the review of the contractors' unallowable costs.

As has been mentioned, of course, a significant amount of time and money was spent on this audit. We have obtained copies of the draft reports that have never been released. Clearly, these draft reports outline significant systemic problems with the way contractors are allowed to charge unallowable overhead costs to the Government. And it is still unclear to me, even after your answers, Mr. Conahan, to the gentleman from Texas, why the GAO has not released the audit results, and this draft report would have been most helpful in addressing the corrections needed to stop these processes, whereby millions of dollars are paid by the Department for unallowable costs.

Now I want to go through with you and see if I can get these dates now, to actually lay out the chronology of the way the work was handled by the GAO.

In 1981, the audit work started. In January of 1983, the audit work was completed. On January 21, 1983, GAO drafted a letter report to Navy Secretary Lehman, and that was never issued.

I think it was one of the attachments that was made available to you. I'm going to be referring to some documents, Mr. Conahan. Do you have those documents there?

Mr. ADAMS. No.

Mr. CONAHAN. No.

Mr. WYDEN. We will get you a copy right away and go through some of these.

In March 1983, GAO drafted a report to the Congress of 46 pages. That was never issued, and there is an attachment there as well.

In June of 1984, there was a second draft of the GAO report to the Congress of 34 pages. That was never issued either, and that is attachment C.

Then we get to July of 1984, with GAO testimony to the House Subcommittee on Legislation and National Security, the Committee on Government Operations, and here we are talking about attachment D.

Now as you said, again, in your comments to the gentleman from Texas, that testimony covered only a small part of the GAO draft report.

On October 29, 1984, there was a GAO letter report of three pages to Secretary Weinberger, and that is attachment E.

As far as I can tell, that was the only report, this three-page report to the Secretary, that was issued on this GAO audit.

Mr. Adams, let me start by questioning you. The subcommittee staff has determined that the first GAO draft report was issued in March of 1983, and that is attachment B that you all have now. The next draft was not prepared until June of 1984, and here we are talking about attachment C.

What was the GAO doing between March of 1983 and June of 1984? This is a 15-month period.

Mr. ADAMS. I am sure that what we were doing was taking the documentation that had been sent to us by our St. Louis suboffice or the Kansas City region, and looking at it, looking at the summaries, trying to see if what we had there was a report which would bear the—or could bear the imprimatur of the GAO. And it takes some time to do that.

Mr. Wyden. How long does it take for the GAO to get an important report like this finished?

Mr. Adams. I'm sure that the length of time will vary, depending on the importance of the document, the resources put on it. It can vary for a number of reasons. And since I was personally responsible for this particular report, I can only say that it probably didn't get as much diligence by my hand as it should have.

Mr. Wyden. Let's go into some of the details on this audit.

How many auditors were assigned to it?

Mr. Adams. I'm sorry. Would you ask your question again, sir?

Mr. Wyden. How many auditors were assigned to this particular audit?

Mr. Adams. Oh, let me see. We had four regions involved, and I would think that there would probably be—now these would vary in length of time, you understand; some of the people would be on it longer than others—but there would be a couple of auditors in Boston, two in St. Louis, two in Dallas, and probably two in Denver, in the Denver region.

Mr. Wyden. How much did the audits cost?

Mr. Adams. I have those figures, sir, but they are not here. They are in our forms at the General Accounting Office, and I'm just not prepared to answer the question.

Mr. Wyden. Do you have even a ballpark idea?

Mr. Adams. I really don't. If I guessed, I could be off by an order of magnitude, and it would serve no purpose. I would be glad to submit it for the record, but I just don't know.

Mr. Wyden. Do you still have plans to issue the June 1984 draft report?

Mr. Adams. No, sir.

Mr. Wyden. Why not?

Mr. Adams. Because in my estimation, what we have submitted picks up the essence of what we found that is necessary to be reported.

Mr. Wyden. You believe, then, that those three pages to Secretary Weinberger are sufficient with respect to this matter? Because as far as I can tell, that is the only report that so far has been issued on this GAO audit, unless I'm missing something.

Mr. Conahan. Oh, I think you are missing something, sir. The testimony before Chairman Brooks was an extended testimony, such as we are having right here now, and all of the matters—I can't say all of the matters—but memory tells me that most of the significant matters discussed in that report were aired in the hearing before Chairman Brooks, and that report has been issued.

Mr. Wyden. Excuse me. I thought that was only promotion and advertising.

Mr. Conahan. Oh, the whole question of bottomline negotiation, the role of the ACO, the role of DCAA, was covered during the question-and-answer periods, much as we are discussing the matter here today.

Mr. Adams. And those concepts are as equally applicable to costs other than, quote, "public relations costs." And I'm kind of sorry that term gets used, because that embraces such a wide variety of the costs of which we speak—travel costs, entertainment, lobbying costs, all of those things can fit into this category.

But the concepts, that is to say, clear up the DAR so that you take away these back-door entrances to put the costs back in, apply far more than to just public relations costs. And we didn't limit our recommendation to the Department of Defense to just public relations costs. We said the FAR in the area of allowables/unallowables should be cleared up.

Mr. **Wyden**. But it was still three pages to the Department of Defense?

Mr. **Conahan**. It was three pages, sir, plus the attachment which was the prepared statement before the House Government Operations Committee, and certainly the Department of Defense and anyone else had access to a rather extensive hearing record and report prepared by the House Government Operations Committee.

I have seen that. I don't have it, but it is part of the public domain at the moment.

Mr. **Wyden**. Are there other draft reports in this defense area that are developed and that are not issued?

Mr. **Conahan**. In the form in which they are initially developed, I would say, yes, sir, there would be some.

Mr. **Wyden**. Such as?

Mr. **Conahan**. Well, such as the kind of thing we are talking about now. If testimony comes up and we get into the hearing record through that testimony as much as we would otherwise get in, in preparing a report, we could very well conclude that that's as far as we need to go on it. It's very costly to prepare a report.

Mr. **Wyden**. Mr. Conahan, I just don't like the sound of this because I don't understand why all this work goes into audits and then reports aren't developed, and the only way it may get out is if a diligent chairman, like Chairman Brooks, goes out and tries to get it.

What it indicates to this member is a certain reluctance on the part of the General Accounting Office to take on the Department of Defense. That is what it looks like to me, and I am just not sure why we are doing these kinds of draft reports. Are they practice reports? What are we doing them for?

Mr. **Conahan**. I must respond by saying that that report would have been issued in whatever form if it were not for the Brooks hearing. But because the Brooks hearing came along, that, we felt, concluded that particular matter.

Mr. **Wyden**. Well, again, I just don't see how a 3-page letter to the Secretary of Defense is a justification for what looks like 2 years on this audit, and again it seems to me that it reflects a certain reluctance to really get important information about changes in contracting practices to the Department who could really do something about it.

Mr. **Conahan**. We actually feel pretty good about this. We feel that we did get the Department to take the kind of action that we thought was necessary. It hasn't gone as far as we should like, and we are glad to have this opportunity to pursue it, but we just felt that the fundamental issues here have been covered.

Mr. **Sikorski**. Would the gentleman yield?

Mr. **Wyden**. I'd be happy to.

Mr. SIKORSKI. There is also a draft letter to Secretary of Navy Lehman that was drafted back in January of 1983, more than 2 years ago, that was not apparently issued. Is that correct?

Mr. CONAHAN. I think we heard from Mr. Adams a few moments ago that that was not issued.

Mr. SIKORSKI. Well, I read from that letter to Mr. Modesitt, I believe yesterday, critical of those overhead expenses back in 1977 for those air carriers. You put a lot of resources into these things and they take a long time I think this one took 2 years. The one we are on now.

Mr. CONAHAN. May I ask you, you said air carriers?

Mr. SIKORSKI. I am talking about aircraft.

Mr. CONAHAN. Air shows?

Mr. SIKORSKI. No, corporate aircraft expenses.

Mr. ADAMS. Well, we may have talked about it there.

Mr. SIKORSKI. Corporate office for calendar year 1977. This was the Modesitt situation. He came in with $4½ million bucks of unallowable costs and he settled for $1½ million even without any documentation. That was the Modesitt situation.

Mr. CONAHAN. That information became part of the material that we discussed with the House Government Operations Committee.

Mr. SIKORSKI. Well, didn't you earlier today tell us that you weren't familiar, Mr. Adams, with the Modesitt situation, any more than what you heard yesterday?

Mr. ADAMS. Yes; I did.

Mr. SIKORSKI. But there is a letter on file that wasn't sent to the Secretary of Navy. It's a draft letter in 1983 that documents your concerns or your—no, it documents your senior evaluator's concerns, Ed Hyde to you, and, you got it?

Mr. ADAMS. Yes; I did.

Mr. SIKORSKI. Thank you, gentlemen.

Mr. WYDEN. Mr. Chairman, I want to ask one other quick question, but it seems to me that if this report had been issued and been issued promptly, it would have helped us to clean up this mess, which is what I asked about initially. And it concerns me and it concerns me greatly, when time is put into these reports and somehow they seem to basically just vanish into vapor, except for a very small, almost abbreviated version that just deals with a couple of portions.

I want to get into one other area just very briefly, Mr. Conahan.

The subcommittee has been concerned about overseas payments, overseas payments by defense contractors. And my question to you is, when companies hire overseas consultants and pay $250,000 per year for 5 years, that would be a total of $1.25 million in the area that we're looking at, are any suspicions raised about possible violations of the Foreign Corrupt Practices Act in that kind of situation, in your minds?

Mr. CONAHAN. In an immediate reaction, I would certainly have to call that legislation to mind. I think we need to take a look at the details of that before we reach a conclusion.

Mr. WYDEN. What steps do you think need to be taken to ensure that there are no violations of the Foreign Corrupt Practices Act in these kinds of situations?

Mr. CONAHAN. I think that the defense contract agency needs to do sufficient audit work to determine what the justification for those payments is.

Mr. WYDEN. Do you think that they are doing sufficient audit work at present to determine the justification for these kinds of payments?

Mr. CONAHAN. I think that there is always room for increased audit activity, notwithstanding the high level of audit activity that occurs in Government right now, and there is a high level of audit activity. But there is also an awful lot of Government activity underway right now. I can't reach a firm conclusion, but I suspect that the Defense Contract Audit Agency is simply not in a position to look at every voucher. I will make that statement. I don't think that it can. As a matter of fact, I think that it recently had to go to sampling techniques and things like that, in order to get the kind of coverage it feels necessary.

Mr. WYDEN. But do you think they ought to look at more vouchers in this area? This strikes me as a very serious area, and would require more than just sampling. Do you agree with that?

Mr. CONAHAN. I think that this currently is an area of concern. As we testified earlier, some years back, most of these determinations were made on the basis of audits, that the auditor would go in and note these items as being unallowable and, for the most part, they were disallowed.

However, a change was made here some years ago where the contracting community, specifically the contracting officer, got greater authority than he had in the past, and the audit determination was phased out over a period of time, and the contracting officer was making the final decision.

I think it is from that time forward that we began seeing some of these kinds of things occurring, and I don't think, although I haven't looked specifically, that we would have found this level of that kind of activity back when audit determinations were the name of the game.

Mr. WYDEN. I would certainly hope we would look more extensively at this area in the future, because it seems to me just fraught with possible violations of the Foreign Corrupt Practices Act and other areas that certainly are very questionable in nature.

Thank you, Mr. Chairman.

Mr. DINGELL. The time of the gentleman has expired.

The gentleman from Texas, Mr. Bryant.

Mr. BRYANT. Mr. Conahan, you are the Director of the National Security and International Affairs Division of GAO. Is that one of several divisions?

Mr. CONAHAN. Yes, sir.

Mr. BRYANT. Do you report directly to the Chief Administrator?

Mr. CONAHAN. Yes; sir, the Comptroller General of the United States.

Mr. BRYANT. The Comptroller General runs the agency?

Mr. CONAHAN. Yes, sir.

Mr. BRYANT. What has been the history of your career? Have you been with the GAO for many years?

Mr. CONAHAN. I have. I came into the General Accounting Office after graduation from college. My educational background was in accounting. I have had a wide variety of experiences in both the civil side as well as the international side, and just recently been named to head this new group at GAO.

Mr. **Bryant**. And Mr. Adams is a group director within GAO. Is that one step below division head?

Mr. **Adams**. No; that is several. It's a couple of steps below.

Mr. **Bryant**. And is your background similar? Are you a career GAO——

Mr. **Adams**. No; no. I'm a relative newcomer. I spent 19 years working with industry at North American Aviation, which is now part of Rockwell. Then I spent 10 years on the staff of the Cost Accounting Standards Board writing cost accounting standards, which I hope contribute or should contribute to the solution of the problem.

Mr. **Bryant**. I would like to ask you about the Armed Services Board of Contract Appeals. When Mr. Modesitt was here yesterday, I asked him why he couldn't just simply say no to General Dynamics, that these expenses they were asking to be reimbursed for had no documentary foundation, there was no list of people who traveled on the airplanes, so why couldn't he just say no to that? You didn't follow the rules, so you don't get your money? And he responded that, well, then it would go to the Armed Services Board of Contract Appeals and gee, we sure have a bad record there, so we think it's better just to settle out with them.

Is that an accurate characterization, in your opinion?

Mr. **Conahan**. I think that most contracting officers feel that they are not going to fare very well if the case goes to the Armed Services Board of Contract Appeals. I think that most contractors, when they go there, feel that they have got a better than even chance of winning the case, and thus you don't find too many contractors going when they don't feel they have a good chance, so that the outcome is pretty much dictated up front.

Mr. **Bryant**. Is it true that the legal fees they incur, when they go to that Board of Contract Appeals are paid by us, paid by the taxpayers?

Mr. **Adams**. Yes; they are.

Mr. **Bryant**. They are. So there is absolutely no reason not to appeal every single thing that a man like Mr. Modesitt complains about; isn't that correct? There is no cost in appealing, so why not do it?

Mr. **Conahan**. Yes, but I don't think that's been the history.

Mr. **Bryant**. Well, let me get to the history in a second. But why wouldn't you just go ahead and appeal it? It doesn't cost anything. The people you are trying to get the money out of are paying your legal bills, so why not go ahead and appeal it?

Mr. **Adams**. Well, yes, in my past experience and in my current experience, I find that there is a cost, but it basically is a problem of an ego cost. There is a desire not to take a case that you don't think you can win and, therefore, much of the recommendations that come back——

Mr. **Bryant**. I never turned a case down one time in law practice where somebody offered to pay me $100 an hour because I couldn't win it. I was glad to make the 100 bucks an hour. These guys make a lot more money than that.

Mr. **Adams**. Well, nonetheless, often when a—the way the system works, a contracting officer, an ACO, will decide he is going to challenge one of these costs. He will then always, without a doubt, surface it to the next level of his administrative supervision and say, "I'm going to make a unilateral determination. Should I do so?" Explain the facts, and then they will decide, do we have enough facts on our side to win the case.

And very often they get the answer, the litigative risks are too high. I would suggest you not proceed.

Mr. **Bryant**. I'm sorry, who gets that answer?

Mr. **Adams**. That will come from his administrative supervisor. For example——

Mr. **Bryant**. You are talking about on the Government's side?

Mr. **Adams**. Oh, yes, yes. Just strictly talking about the Government's side of this case.

Mr. **Bryant**. Well, suggest it to a person like Mr. Modesitt, that the cost of litigation is high enough that it's not worth the risk?

Mr. **Adams**. Exactly. And they will say that the litigative risk is so high that we recommend you don't take this course.

Mr. **Bryant**. Well, particularly if you consider the fact that if you turn them down, then they make you pay for the cost of taking you to court.

Mr. **Adams**. That's right.

Mr. **Bryant**. Well, doesn't it seem logical to you that the taxpayers shouldn't pay their attorney's fees to help them get more money out of the taxpayers?

Mr. **Adams**. Yes.

Mr. **Bryant**. Have you made a recommendation like that?

Mr. **Adams**. No.

Mr. **Bryant**. Would that kind of recommendation be your responsibility, or should that come from somebody else?

Mr. **Adams**. I would have to study that and see just what it would fall within the purview of the General Accounting Office.

Mr. **Bryant**. Who makes up the Armed Services Board of Contract Appeals? Not names, but I mean what are they?

Mr. **Adams**. These are civilians who are hired by the Department of Defense.

Mr. **Bryant**. Are there some retired military people on the board?

Mr. **Adams**. I don't know whether there are now. I know there have been. Col. Ned Hand was on the board for a while. I know he was a retired officer. But whether there are today, I just don't know. I haven't been that close to them.

Mr. **Bryant**. Are there retired executives from defense contractors on the board?

Mr. **Adams**. I could almost say categorically no, that there are not.

Mr. **Bryant**. Well, you said—who picks them? The Secretary of Defense?

Mr. **Conahan**. There is a board—these are selected by either the Services or by the Office of the Secretary of Defense, by the procurement offices within either the Services or the Secretary of Defense.

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Mr. **Bryant**. Why would the bias not be the other way? Why would not our auditors feel confident that reasonable doubts be resolved in their favor, rather than in favor of the defense contractors? Why is it the other way around?

Mr. **Conahan**. I have not looked at the situation to the extent necessary to answer that question. That is a perception. I have not gone behind the perception.

Mr. **Bryant**. Don't you have an audit going of that right now?

Mr. **Conahan**. Not of the outcome of the board. We have not looked at the outcomes of the board. We have looked at some things. We have looked at who makes up the board, and we have answers to that question, and how they are appointed.

One thing we tried to get a handle on was their independence, because that has been a major question, that is their independence. What we were able to do was to talk to a number of people, both on the Government side as well as the other side, and we found no evidence that lack of independence is affecting their decisions. That's the best I can say at the moment, we haven't found that there were undue pressures or burdens brought to bear on these people.

Mr. **Bryant**. When are you going to complete that study?

Mr. **Conahan**. That study is in draft. I don't like to use that term at the moment, but—well, drafts sometimes never show up. That study hopefully should be completed within 45 days.

Mr. **Sikorski**. Would the gentleman yield?

Mr. **Bryant**. Surely.

Mr. **Sikorski**. Are you going to look at results? You know, Mothers Against Drunk Driving look at the results of DWI prosecutions and the rest of it. Are you going to look at these various judges and see where they end up in terms of supporting or affirming or denying what the auditor comes up with?

And second, when they do make a decision, do they have to specify in the same way we are recommending for the ACO's what the settlement is based on?

Mr. **Conahan**. Yes. But they, of course, are faced with the same difficulty that the ACO's are faced with. They have got the same criteria before them, this FAR criteria.

But in answer to your first question, no, we are not looking at the results as part of the study.

Mr. **Sikorski**. Well, I would encourage you to look at it, but beyond that, we know the ACO's have to, and we also have all kinds of indications, and you know that they are not specifying item by item. Do the boards, when they make their decisions, come up with an item by item——

Mr. **Adams**. In answer to your question, incredibly so, yes. They describe it in great detail.

Mr. **Sikorski**. So we can tell when they are approving 200 dozen golf balls?

Mr. **Adams**. No, they don't ever get that detailed. Excuse me. They would do it from the points of law raised or the points of fact raised. But I have not seen them get into that specific detail.

Mr. **Sikorski**. Were you here yesterday when we went through all these vouchers from Pratt-Whitney?

Mr. **Adams**. Yes.

Mr. **Sikorski**. Well, do they get that specific, or do they just take a big chunk under "entertainment" and throw it in there?

Mr. **Adams**. I have not read all cases, and now I am on some weak ground, because I haven't read them all, but I have not seen any where they would go into those specific details.

Mr. **Sikorski**. So we end up with the same situation with them that we have with the people who are negotiating the settlements, and that is, there's no item-by-item analysis that allows an outsider to review the propriety of their judgment.

Mr. **Adams**. Well, there is considerably more, in my opinion, in the ASCBA, in their write-ups than I have perceived in the post-negotiation memorandum to be prepared by the ACO, yes.

Mr. **Sikorski**. Well, take the Modesitt incidence of the overhead out of headquarters at General Dynamics, where they come in with $1.5 million of unallowable, DCAA finds unallowable $4.5 million. Assume that wasn't agreed to or you wouldn't come down enough, and they took that up to the ASBCA.

What would happen? And they made a decision. Would we be able to find out whether they were given money for vouchers, for blank vouchers?

Mr. **Adams**. Yes, I think we would. If they took that particular case, yes, I think we clearly would.

Mr. **Sikorski**. What about the Spanton instance, with the golf balls and the swanky parties and the charter fishing trips and all that stuff, the prisms and the baseball caps and the rest of that?

Mr. **Adams**. I'm sure that if it got taken in that form, they would deal with it individually.

Mr. **Sikorski**. OK.

Mr. **Bryant**. Mr. Adams, has the GAO ever studied the individual performance of the members of the Armed Services Board of Contract Appeals?

Mr. **Adams**. Not to my knowledge.

Mr. **Bryant**. Is there any reason why you haven't done that?

Mr. **Conahan**. We undertake each year to decide what we think should be done, and we have had internal planning process in place for some years now. In addition to that, we respond to requests from committee chairmen and members of the Congress. About 50 percent of our work currently is in response to requests from chairmen, and the other half on our own hoof.

Most of the work that we do at our own initiation is work that we feel compliments work that we have been asked to do by members or committee chairmen, and the body of work that we are presently doing was one that we were asked to do by a Senate committee, and it didn't get into that particular question, so it just has not come up in our own planning process.

Mr. **Bryant**. Doesn't it seem to you that it would be a logical thing to do since that seems to be the reason why people like Mr. Modesitt say they refuse to turn down these claims, because they know they will lose at the board?

Mr. **Conahan**. I think it's a meritorious project. My response is that there are a lot of those meritorious projects, and each time we get into one, there is a new one that pops up.

Mr. **Bryant**. One more question. Do you think in your experience with these boards, do you think the Government lawyers who represent our side in these contract disputes before this board are equal in quality to the private lawyers hired by the defense contractors?

Mr. CONAHAN. I don't think that we have done sufficient work to reach a conclusion on that.

Mr. BRYANT. Mr. Adams, do you have an opinion on that? Not about how much work you have done, but just your opinion in terms of your observations.

Mr. ADAMS. I would say that in my perception there is the same degree of professionalism and the same degree of competence; the same spectrum lays over the private sector attorneys as over the Government-sector attorneys.

Mr. DINGELL. Would the gentleman yield? How about numbers, and how about resources on which the Government lawyers may call?

Mr. ADAMS. It is my perception that there there is not an equal——

Mr. DINGELL. What are you saying?

Mr. ADAMS. That the numbers that would represent industry would be far greater than——

Mr. DINGELL. You mean a lot of private lawyers and maybe one government attorney?

Mr. ADAMS. Yes.

Mr. DINGELL. So you don't find that to be a fair allocation of effort on the part of the Government as opposed to the defense contractors; is that right? In other words, it is like one man fighting six or seven. The odds are bad.

Mr. ADAMS. Well, I wouldn't characterize it as being that bad.

Mr. DINGELL. How bad would you characterize it as being?

Mr. ADAMS. Just that in my perception there are——

Mr. DINGELL. They are thoroughly outnumbered?

Mr. ADAMS. No. Generally that there are more resources available in the——

Mr. DINGELL. How about backing? We have talked about the numbers of lawyers. How about the backing by the defense contractor versus the backing by the Government agency? How do those two forces compare?

Mr. ADAMS. I can't identify your question.

Mr. DINGELL. Well, the Government will just arbitrarily compromise on about 53 percent of the figures, according to some of the comments in the testimony of yours and Mr. Conahan. Am I fair in inferring that this indicates that perhaps the Government is rather anxious to take the case of Mr. Modesitt, to settle the case on almost any terms?

I don't gather that the defense contractor has the same enthusiasm for settling on the Government's terms.

Mr. CONAHAN. Oh, I think that our findings in that regard confirm your view.

Mr. DINGELL. To help me and to help the record, what are you saying?

Mr. CONAHAN. I'm saying that the defense contracting officer finds that he does not have the backing necessary to take unilateral decisions in disallowing costs.

Mr. DINGELL. The same thing would be true with regard to the Government attorney dealing with the case.

Mr. CONAHAN. Except that I can't comment on that. I can't comment on the former.

Mr. DINGELL. But you will say that is true in the case of the Government contracting officer?

Mr. CONAHAN. Yes, sir.

Mr. DINGELL. I thank the gentleman.

Mr. BRYANT. Mr. Chairman, I would just like to make the observation that the situation apparently is that we pay a Government lawyer $50,000 or $60,000 a year to handle all these cases all year long, and undoubtedly the kinds of fees charged by these big law firms, we spend that much per case, and we are paying both lawyers, both the Government lawyer and the lawyer for the defense contractor, win or lose. It's a ridiculous situation.

Mr. WYDEN. If the gentleman would yield, I think he makes an excellent point. One area, either by legislation or other appropriate remedy, ought to be to limit some of these fees.

Mr. DINGELL. The time of the gentleman has expired.

The gentleman from Kansas.

Mr. SLATTERY. Very briefly, Mr. Chairman, I know we are anxious to get on to some of the other testimony, but I am just wondering. You gentlemen have been involved in this whole process for several years, at least, and in the last few years, we have clearly seen a rather astonishing record of Government inability to effectively monitor this whole contracting process.

Very briefly, can you tell us from your perspective why you think this has happened, No. 1, and very simply, what you think the Congress should do legislatively to correct it?

Mr. CONAHAN. I think that——

Mr. SLATTERY. Why have we seen these overbillings of literally hundreds of millions of dollars?

Mr. CONAHAN. I think that, first off, we have to recognize that there has been a tremendous increase in the funding for defense procurement. That's one thing.

Mr. SLATTERY. Or would you say that there is a real problem in that there has been such an enormous funding increase that we just can't keep track of the money?

Mr. CONAHAN. We had mechanisms in place 4 years ago to administer programs at a certain level. Those mechanisms today haven't really changed very much to administer a level which is almost twice as great as it was 4 or 5 years ago.

Mr. DINGELL. Would the gentleman yield?

Are you telling me that those levels of ability are not equal to the stress that is put on them by the demands of the size of the system that they are supposed to police and regulate?

Mr. CONAHAN. I think that insofar as the administrative side of those mechanisms is concerned, that some further help is required to sustain this high level of activity.

Mr. DINGELL. I thank the gentleman.

Mr. SLATTERY. Has there been any increase at all in terms of the staff that the different departments utilize to monitor these contracts? In 1980 we were spending maybe $150 billion a year in terms of outlays, and now we are up to close to $275 billion.

Mr. **Conahan**. I think that the Director of DCAA will be on here later and he can give you a specific answer insofar as his organization is concerned. Generally, there have been some modest increases, but not tremendous increases. In our organization, for example, our overall staffing has decreased over the past 4 years.

Mr. **Slattery**. So you are saying one of the reasons is that we are spending so much more money.

Now what else?

Mr. **Conahan**. I think secondly, as I mentioned before, insofar as these specific kinds of costs are concerned, when we had audit determinations driving the final allowability of costs, these costs were being disallowed to a greater extent than I believe they are right now. We have underlying this negotiation process a regulation or a set of regulations which are ambiguous, and the contractor or the contracting officer, DCAA and everyone else involved in this process is burdened with these ambiguous regulations, and we feel they need to be changed.

Third, there needs to be a resolve on the part of the decisionmakers in the Department of Defense to back up the people that we put into these administrative positions to assure that the interests of the Government are being served.

Mr. **Slattery**. Is it your view that the officials in the Pentagon, then, are not backing up their own administrative auditors?

Mr. **Conahan**. I think there is an attitude within the Department of Defense which says that we need to get these programs completed and that the priority is in getting the program completed, and that sometimes—and I can't characterize whether it is sometimes or oftentimes, but that does give way from time to time to holding people more accountable than they should be.

Mr. **Dingell**. You mean holding people more accountable gives way to that goal of expeditiously completing the program?

Mr. **Conahan**. I am saying, sir, that I don't think there is as much accountability over there as there needs to be.

Mr. **Dingell**. And that accountability is taking second place to the accomplishment of the program?

Mr. **Conahan**. The lack of accountability.

Mr. **Dingell**. That's what I'm saying.

Mr. **Conahan**. I think that is true.

Mr. **Slattery**. Have you detected a change in attitude from the highest levels of the Pentagon? For example, we have been involved in the General Dynamics hearings here for several months now, and during this process, we have heard the Secretary of Defense make some pretty harsh statements and then a few days later it seems like we are back to business as usual.

There are disclosures about General Electric, and then 3 or 4 days later we are back to business as usual after some tough talk and a few press releases. What is changing, from your perspective, in the Department of Defense? Are we really dropping the hammer on folks, or are we playing games?

Mr. **Conahan**. I think that the Department can point to a number of initiatives that it has taken over the past couple of years. Now, for reasons that I don't have at my fingertips, a number of those initiatives don't seem to have borne the kind of fruit that was expected. I think there are other things we can point to that have worked. I think we have——

Mr. SLATTERY. Be specific, if you can.

Mr. CONAHAN. I think the manner in which the Department of Defense or the Secretary of Defense has permitted the inspector general operation to work over there, including, specifically, the work that is done by that organization to follow up on suggestions that had been made.

I think they have done a superb job on following through on recommendations made by all audit organizations, to exclude for the moment the Defense Contract Audit Agency recommendations with respect to procurement. I'm talking about in the administrative and operational areas. So that would include his own and GAO and that sort of thing. So I think that is an instrument that is working very, very well.

Mr. SLATTERY. All right. Let's get now, if we can, to some specific recommendations that you would make to the Congress to deal with this problem. We have talked about spending increases being a real problem to account for, so we can deal with that by reducing Pentagon budgets.

The negotiation process, you say, is ambiguous and we need some cleanup, I guess, in the regulations relating to the negotiation process. Do you have any specific ideas?

Mr. CONAHAN. Yes, very much so. Very much so. I think what needs to be done is we have got to decide that entertainment costs are not allowable. Once having decided that, to write this regulation in such a way that they cannot be allowed.

There is a provision here that says entertainment costs cannot be allowable. There is also a provision that says that donations and contributions are not allowable. The regulation talks about fines and penalties not being allowable. It talks about advertising costs except under certain conditions not being allowable.

I think what we need to do is frame these regulations in such a way as to say that these unallowable items are not allowable under any other regulation. They are just plain, flat not allowable. There is then no ambiguity. Then the contracting officer and the contractor and DCAA and everyone else concerned is working with the same very absolute criteria with respect to this category of costs. I think that is one thing that needs to be done.

I don't think we will ever get to the point where we can remove all ambiguity. There certainly will be some left there. But after the FAR is tightened, I think we need to install a requirement that says that the contracting officer will deal with individual items of cost on an item-by-item basis rather than continuing the practice that now exists where he lumps all these indirect costs into a basket, and then they negotiate back and forth on an overall basis.

Third, I think that the contracting officers need: One, to determine up front and document what their prenegotiation position is, to go through and prepare adequate documentation following their negotiation on what they have done, so that we know precisely where we stand from time to time.

Once having gone through this, we have established unallowable costs. The contractor then, under Cost Accounting Standard 405, is required to set those costs aside and thenceforth not ever to enter them into a billing to the Government. I think you are pretty far down the road if you can accomplish that.

Mr. **Slattery**. Thank you. I have no further questions.

Mr. **Dingell**. The time of the gentleman has expired.

The gentleman from Minnesota.

Mr. **Sikorski**. Thank you, Mr. Chairman.

One question. Mr. Adams, years ago most of these audits were done—I think that this was touched on but I wanted it specifically in the record. Most of these overhead settlements were done by auditors under audit determination. In 1978, the defense acquisition regulations changed to provide for a determination by procurement officers, the contracting officers.

Would you recommend a return to the audit determination?

Mr. **Adams**. Yes, I would. Before I develop that answer, let me correct a misstatement I made earlier about legal costs. I am reading from the FAR, 31205.33, which are professional consultant services costs. It says:

> Costs of legal and accounting and consulting services and directly associated costs in connection with organization, reorganization, or the prosecution of claims against the government are disallowed.

Mr. **Sikorski**. So they don't get——

Mr. **Adams**. They do not get reimbursed the legal costs of taking a claim. So they don't have that advantage.

Mr. **Sikorski**. At what point does that take?

Mr. **Adams**. Once a unilateral determination is made by a contracting officer, that is making a decision that the contractor is not going to get these costs. And once he makes that decision, the only way a contractor gets it is to make a claim through the ASBCA.

Mr. **Sikorski**. But the costs before that are allowable.

Mr. **Adams**. Yes, because I assume that they are just part of the normal operation.

Mr. **Sikorski**. Well, that is where the discovery work, the other kind of detail work is done in the litigation process, and beyond that, there is a big incentive for them to negotiate these things out because if they get disallowed at a later level—what is it, the 405?

Mr. **Adams**. Yes.

Mr. **Slattery**. Would the gentleman yield on that point?

Mr. **Sikorski**. OK.

Mr. **Slattery**. Very briefly, are we talking about consulting firms and lawyers that are hired specifically to pursue something like this, or are we also talking about in-house lawyers? Because if, for example, General Dynamics is doing 94 percent of their business with the DOD, and if they have in-house lawyers to handle these kind of problems, can they not bill that to the Pentagon as allowable overhead charges for a certain project even though they have not specifically contracted with outside firms? Do you see what I'm saying?

Mr. **Adams**. Yes; I see exactly what you are saying, and I don't know how these words are being interpreted by the auditors. You may be able to ask that of later witnesses today. But all it says is cost of legal accounting, and then it puts a conjunctive "and" consulting services. So it doesn't imply that they are talking about consulting legal services.

Mr. SLATTERY. Another area of ambiguity.

Mr. SIKORSKI. Would you tell me, besides the "yes," would you like to amplify your answer?

Mr. ADAMS. Yes. In the whole development of this, if you will, complex relationship between Government contractors and the Government, the area of costs has really been a problem. Years ago, when a DCAA auditor would want to question a cost, he would use a Form DD-296, and that was a recommendation to the contracting officer that these costs be disallowed.

The contracting officer then could accept that or not accept that and proceed on. In the mid-1960's——

Mr. SIKORSKI. I am going to have to leave to vote, but the record will reflect your answer.

Mr. ADAMS. All right. In the mid-1960's, they came up with a Form 1 which was a case of where the auditor could question the cost and that cost was disallowed under the Form 1. And then the contracting officer would have to make a step forward and say, "I am going to overrule you, DCAA, and make those costs allowable," and that was a major step in terms of giving DCAA some authority or some additional say in terms of the——

Mr. DINGELL. You say that was changed?

Mr. ADAMS. That was changed back in the mid-1960's, and they were then given the Form 1 authority.

Mr. CONAHAN. That was changed again.

Mr. DINGELL. That was changed again?

Mr. ADAMS. That's correct, yes.

Mr. DINGELL. How was it changed?

Mr. ADAMS. Let me read to you from the previous DAR which is the Defense Acquisition Regulations, and in the previous regulation—I am reading now from part 7 in section 3 of DAR, establishing overhead rates, and this change was put in, in 1978, and it provides that final overhead rates shall be established by procurement determination.

Mr. DINGELL. What does that mean?

Mr. ADAMS. Essentially what that means is that it will be done by the ACO, by the contracting officer.

Mr. DINGELL. That's really not a change for the better.

Mr. ADAMS. In my estimation, no.

Mr. DINGELL. What it means is the guy that issued the contract interprets the contract, and apparently it means he interprets the contract and settles on the matter without consultation with the auditor, is that correct?

Mr. ADAMS. Not without consultation. He does have the consultation with the auditor. Now this says——

Mr. DINGELL. But that is just a consultation. A consultation could be, "This is what I am going to do."

Mr. ADAMS. That's right.

Mr. DINGELL. It's pretty hard to say that the auditor has much say in that kind of circumstance.

Mr. ADAMS. There was at this time also a provision that provided for establishment by audit determination.

Mr. DINGELL. Pardon?

Mr. ADAMS. I say in this same DAR, back in 1978, there was for some contract activities, what they call establishment by audit determination.

Mr. DINGELL. Now what does that mean?

Mr. ADAMS. In this case, the auditor makes the evaluation of the audit accounts and serves it up to the contracting officer.

Mr. DINGELL. And what happens then?

Mr. ADAMS. In the audit determinations, that is generally determinative, unless the contracting officer then takes some overt action to say, "I am disallowing some of those, some of your rulings."

Mr. DINGELL. All right. Now what is the criteria for the second situation that you have defined, the last of the two that you have discussed with us? In what instances does that occur, and in what percentage of cases does that occur?

Mr. ADAMS. It says the use of procurement or audit determinations in accordance with the following criteria. The final overhead shall be established by procurement for all locations of a multi-divisional contractor complex for which a corporate administrative contracting officer has been established on a coordinated or centralized basis as jointly determined by the CACO.

Mr. DINGELL. What does that mean, in terms of size? Big guys get one treatment, and little guys get a different one?

Mr. ADAMS. That probably oversimplifies it, but that's about it.

Mr. DINGELL. Don't you let me oversimplify. You tell me what it does. I gather that you are telling me the little guys get one treatment and the big guys get another treatment. Now you say that oversimplifies. I want to be fair here, and I want you to tell me what the facts are.

Mr. ADAMS. Well, I think it is too general that say big guys get one treatment and little guys get another.

Mr. DINGELL. But you do say it happens, although it's oversimplified?

Mr. ADAMS. Yes. I'm saying that where you have an ACO, normally if you have an administrative contracting officer in residence—and when I say in residence, that would generally imply it is a larger company. It may not be large, but it is a larger company.

Mr. DINGELL. A larger company, or a larger contractor?

Mr. ADAMS. Both. I am using the terms almost interchangeably in this case. Or a division of a company or segment of a company.

And if they have enough business to have a resident ACO, I am assuming that what they are suggesting here is that you will make these settlements by procurement——

Mr. DINGELL. The resident ACO makes a decision. The contractor doesn't have much say.

Mr. ADAMS. That's right.

Mr. DINGELL. What is the practical difference in the size of corporations or the size of contractors? What would be the breaking point where you shift from the one mechanism to the other?

Mr. ADAMS. Oh, it would be hard for me to say. I don't know—let's say you are talking about a contractor with sales of $100 million. I'm sure he is going to have a resident ACO. I would predict. I don't know that.

Mr. DINGELL. OK. The practical result of this in terms of settlement means what? More favorable settlements go to the big guy or the little guy?

Mr. ADAMS. Well, it's certainly easier for the ACO to perform his act with less scrutiny, yes, in my estimation.

Mr. DINGELL. And the practical result of that, in your view, would be that the bigger guy gets a little more favorable treatment where there is a conflict as to the allowability of items under the contract?

Mr. ADAMS. There is certainly less weight given to the auditor's findings in those circumstances, it appears to me.

Mr. DINGELL. If we really wanted to save money, we ought to deal with this uniformly, should we not?

Mr. ADAMS. I could say that I would recommend that the audit by determination is a very viable way to go.

Mr. DINGELL. What is the justification for this change in treatment between the two? Does any come to mind? Either Mr. Adams or Mr. Conahan.

Mr. CONAHAN. No, sir, I am not aware of the justification for that.

Mr. DINGELL. Maybe we will ask the Defense Department to explain it to us.

The gentleman from Oregon.

Mr. WYDEN. Mr. Chairman, I think you are asking about a very important area, and I just want to make sure I have it clear in my mind, because it seems to me that there is a double standard, and as far as I can tell, the findings of the auditors are binding on the small firm, but for the big firms they get to negotiate. And then as Chairman Dingell brought out yesterday, once you get to negotiate, you always end up with a pretty good chunk of money before you are done.

Isn't that a pretty good description of the process, Mr. Adams?

Mr. ADAMS. Yes. Yes. The situation——

Mr. DINGELL. You are not being criticized by the subcommittee, Mr. Adams, for your comments.

Mr. ADAMS. I may be in hot water with the General Accounting Office, I'm not sure.

Mr. DINGELL. Well, if you are, you just come back up here and tell us, and I guarantee that the General Accounting Office will suddenly be in hot water.

Mr. CONAHAN. Well, but I think there are two procedures, and in the one case there is still an avenue for an administrative officer to cause a different decision than was made by the auditor, is that not correct, even in the small companies?

Mr. ADAMS. Yes.

Mr. CONAHAN. So there is that additional procedure there.

Mr. ADAMS. You see, the flavor of this thing moves in the sense that if you read and establish by audit determination in the DAR dated September 1981—I could go down to the bottom and it says, "In the event agreement is not reached, the auditor will issue, in addition to the advisory audit report, a DCAA Form 1, dealing with the items of exception to which the contractor can formally appeal to the cognizant ACO."

That is a major step, and that says he has made those costs unallowable and the only way they are going to be made allowable is if the contracting officer takes an overt step to do so.

You find in the new FAR no reference to the Form 1 at all. Now I haven't done enough research to know whether or not that Form 1 has gone out of use, but you will have a witness later on today whom you can ask that question of, as to whether or not DCAA still has access to Form 1.

But when they talk about audit negotiation now, audit determination procedure, there is no reference now to the Form 1, and that is why I took a few minutes to develop the history of that Form 1 as being a fairly major step forward in giving the auditor some clout in this complex procurement process.

Mr. DINGELL. After they took it all away from him in the late 1960's.

Mr. ADAMS. Well, they gave it to him in the mid-1960's with the Form 1 is what I'm saying.

Mr. DINGELL. I see.

Gentlemen, the Chair wants to express the thanks of the subcommittee. As you observed, I have to apologize to you for last night for not being able to hear your testimony yesterday. You have been very patient and you have certainly again restored the confidence of the subcommittee rather, not restored, but enhanced the confidence of the subcommittee in the General Accounting Office, and we certainly commend you for your testimony and your dedication to the public interest. It has been a privilege to have you both here before us. We appreciate it. We appreciate your presence.

The Chair does observe that we will leave the record open. It may be that the staff will have some questions for you, and I hope that you will find it possible to assist us, if questions come.

Mr. CONAHAN. We certainly will, sir.

Mr. DINGELL. Gentlemen, we thank you.

[Testimony resumes on p. 401.]

[The following documents were submitted:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

MAY 7 1985

RECEIVED
MAY 8 1985
Subcommittee on
Oversight and Investigations

B-218788

The Honorable John D. Dingell, Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Enclosed is our report to the Secretary of Defense which discusses the need for the Department of Defense to improve its system to prevent payment of defense contractors' unallowable overhead costs.

This report is based on our testimony of April 24, 1985, before your subcommittee on defense contractors' overhead costs. We are recommending that the Secretary of Defense:

--Direct the Defense Acquisition Regulatory Council to coordinate with the Civilian Agency Acquisition Council to amend Federal Acquisition Regulation (FAR) secton 31.205 to state that all costs made specifically unallowable under any subsection of FAR 31.205 are not allowable under any other subsections of FAR 31.2.

--Direct administrative contracting officers to negotiate, settle, and document costs questioned as unallowable by the Defense Contract Audit Agency on overhead claims on an item-by-item basis.

We are sending copies of this report to the Chairmen, House and Senate Committees on Appropriations, House and Senate Committees on Armed Services, House Committee on Government Operations, and Senate Committee on Governmental Affairs, and to the Director, Office of Management and Budget.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Enclosure

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

MAY 7 1985

B-218788

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

Subject: Improvements Needed in Department of Defense Procedures to Prevent Reimbursement of Unallowable Costs on Government Contracts (GAO/NSIAD-85-81)

On April 24, 1985, we testified before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, on the need to improve the Department of Defense's (DOD's) system to prevent payment of defense contractors' unallowable overhead costs. This hearing focused on questionable overhead billings by major defense contractors. Our testimony was based on our review of Administrative Contracting Officer's (ACO's) final overhead cost settlements at 12 major DOD contracting activities. Enclosed is a copy of our testimony which provides additional details on our discussion of defense contractors' unallowable overhead costs.

Our review noted that there were numerous instances where the Defense Contract Audit Agency (DCAA) was challenging, as unallowable expenses, significant amounts of contractor costs, but the ACOs were overruling DCAA and allowing a significant percentage of the costs questioned by DCAA. For example, at the 12 contracting activities we reviewed, $31 million of costs challenged by DCAA as unallowable were introduced into negotiations. In the ensuing negotiations, the ACOs allowed into overhead $16.5 million, or 53 percent.

Ambiguities in the Federal Acquisition Regulation (FAR) cause contractors, DCAA, and contracting officers to have different interpretations on allowability. If a contractor believes a specific cost item is subject to interpretation, the contractor generally includes the cost in overhead. DCAA, in performing its overhead audits, uses the same FAR criteria but often arrives at a different interpretation and, therefore, questions the costs. If the contractor does not concede the questioned costs, they will be introduced into negotiations between the contracting officer and the contractor.

Additionally, there is a reluctance on the part of contractors and ACOs to negotiate and agree to items of cost questioned by DCAA audit reports on an item-by-item basis. This reluctance apparently stems from the knowledge that once an item of cost, such as institutional advertising, is mutually agreed to as being unallowable, Cost Accounting Standard (CAS) 405 "Accounting for Unallowable Costs" would require that, thenceforth, such costs would have to be excluded from any billing, claim, or proposal applicable to a government contract. CAS 405 was promulgated to facilitate the negotiation, audit, administration, and settlement of contracts by establishing guidelines covering: (1) the identification of costs specifically described in FAR as unallowable and (2) the accounting treatment to be accorded such costs.

It is the reluctance to identify and mutually agree to specific cost items on the part of the contractors and the acquiescence to this procedure by ACOs which produces the "bottom line" negotiations which we found prevalent. By agreeing to the compromise figure in total, without addressing specific cost items such as airshows, entertainment, or giveaways, contractors can continue, year after year, to keep these costs in the overhead proposal for bottom line negotiations. We believe more aggressive pursuit by contracting officers in identifying and documenting individual items of cost in overhead settlements as unallowable would contribute to the effectiveness of CAS 405 and represent a major step toward preventing reimbursement of unallowable costs on government contracts.

IMPROVING THE SYSTEM

We believe the system which DOD now employs to prevent reimbursement of unallowable costs on government contracts should be improved in two ways.

First, the appropriate sections of FAR should be clarified in such a way as to eliminate present ambiguities that are allowing a wide divergence of opinions among DCAA, the contractors, and the ACOs. We recognize that the criteria for all cost items cannot be written in such a way as to remove all ambiguity and that there undoubtedly will remain differences and disagreements as to the allowability of certain costs. We believe, however, that there are opportunities to clarify the criteria for some of the cost items so as to reduce these differences and disagreements.

In 1984, we reported to you on our review of ACO final overhead cost settlements at 12 contracting activities[1]. In that report we stated that overhead negotiations could be improved if FAR was less ambiguous in its definitions on the allowability of specific overhead costs--especially those costs which could be classified in a general way as contractors' public relations activities.

We recommended that you direct the Defense Acquisition Regulatory Council to coordinate with the Civilian Agency Acquisition Council to:

--Clarify the FAR criteria for the cost categories of advertising and selling to reduce the ambiguity surrounding these costs.

--Specifically address in FAR the circumstances under which the cost elements of air shows, exhibits, displays, promotions, models, and giveaways will be considered allowable or unallowable.

We are pleased to note that a proposed change to FAR 31.109 "Advance Agreements" and FAR 31.205-1 "Advertising Costs," is now being circulated for comment. This gives specific definition to public relations and advertising costs and specifically addresses circumstances under which these types of costs are allowable or unallowable. The proposed change is a positive step and should eliminate much of the confusion concerning these costs.

However, we believe that the FAR revision should go further. The proposed change would add a provision to FAR 31.205-1 stating that costs made specifically unallowable under any subsection of FAR 31.205-1 cannot be made allowable under other subsections of FAR 31.2, which, among other things, define the allowability of costs. We believe FAR should be amended so that any cost made unallowable under any subsections of FAR 31.205 "Selected Costs" cannot be allowable under any other sections of FAR 31.2.

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[1] Ambiguous Federal Acquisition Regulation Criteria on Defense Contractors' Public Relations Costs (GAO/NSIAD-85-20, October 29, 1984.)

There are costs other than public relations and advertising (31.205-1) which are made unallowable by one subsection but allowed into the negotiation process by another subsection. Costs such as "Contributions and Donations" (31.205-8), "Entertainment Costs" (31.205-14), and "Lobbying Costs"(31.205-22) are examples of costs which appear expressly unallowable, but are often recovered in contractors' overhead through other subsections in FAR. For example, at one contractor DCAA questioned $15,000 as unallowable entertainment costs. The ACO held that the expenses also fell within the definition of "Trade, business, technical, and professional activity costs" and on that basis reinstated $9,200. Under our proposed change, the costs could not be reinstated once they met the definition of entertainment. We believe the change we are proposing would reduce differences and disagreements among contractors, DCAA, and ACOs; improve overhead negotiations; and reduce inconsistent treatment of costs under FAR section 31.205 Selected Costs.

A second improvement to the current system would be to establish a requirement for ACOs to negotiate and settle the costs questioned as unallowable by DCAA on overhead claims on an item-by-item basis. As previously stated, these settlements are usually on a total or bottom line basis, with an approximate 50/50 split of costs between the contractor and the government being the general rule rather than the exception.

We believe this situation should be modified by requiring that the settlement of each cost item (such as contributions, air shows, entertainment, etc.) be agreed to by both parties before the final overhead settlement is completed. As individual cost items are mutually agreed to by the government and contractor as unallowable, those costs would be eliminated from future billings. This would contribute to the effectiveness of CAS 405 and eliminate the perennial negotiations concerning those costs.

Accordingly, we recommend that you:

--Direct the Defense Acquisition Regulatory Council to coordinate with the Civilian Agency Acquisition Council to amend FAR section 31.205 to state that all costs made specifically unallowable under any subsection of FAR 31.205 are not allowable under any other subsections of FAR 31.2.

--Direct administrative contracting officers to negotiate, settle, and document costs questioned as unallowable by DCAA on overhead claims on an item-by-item basis.

Our work was performed in accordance with generally accepted government auditing standards.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen, House and Senate Committees on Appropriations, House and Senate Committees on Armed Services, House Committee on Government Operations, and Senate Committee on Governmental Affairs; the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce; and to the Director, Office of Management and Budget.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Enclosure

U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

May 28, 1985

Mr. Frank C. Conahan
Director
National Security and
International Affairs Division
U. S. General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Conahan:

Thank you and Clark Adams, Group Director, Research, Development, Acquisition and Procurement Group, for the excellent testimony you offered the Subcommittee on Oversight and Investigations on April 24, 1985, on matters pertaining to the procurement practices of the Department of Defense (DOD). To further assist the Subcommittee in this matter, it is requested that answers be provided to the following questions:

1. You testified that the "DCAA [Defense Contract Audit Agency] has considerable problems, and we have noted those problems." Please describe the nature of these problems. Please furnish supporting documentation.

2. Does the General Accounting Office (GAO) have plans to determine if the DCAA is effective in finding unallowable or questionable charges with regard to overhead audits? If so, what contractors will be reviewed? Will these include the major defense contractors?

3. Please clarify your testimony with respect to the allowability of legal fees under the Defense Acquisition Regulation (DAR). For example, are legal fees allowed under DAR when contractors appeal cases to the Armed Services Board of Contract Appeals? Also, please comment on the controversy involving the McDonnell Douglas Corporation's charging the government for substantial legal costs in their lawsuit against another defense contractor -- the Northrop Corporation. Are these fees allowable under the DAR? Should the DAR limit the legal fees that can be charged by contractors to the government?

4. You testified "that a provision of law, 18 U.S.C. 1001, requires a provision in each contract that holds the contractor to not submitting false claims in the first instance." Does this provision apply to General Dynamics contracts? If so, would personal trips made on the corporate aircraft and billed to the government, such as those admittedly made by the Chairman of the Board and the Chief Executive Officer, constitute an apparent violation of this provision?

5. Please clarify your testimony with respect to "audit determined" overhead rates. Why does the DOD allow the DCAA to use audit determined overhead rates for small contractors whereas larger contractors are allowed to negotiate overhead rates? Is the GAO recommending that this distinction be eliminated?

6. Mr. Adams testified that "we have already written to the Department of Defense in one case saying that we believe that the documentation should be written better, that the contracting officer should write them better." Did the Department respond to this letter? Please furnish copies of the GAO and DOD correspondence.

Your continued assistance to the Subcommittee in this matter will be appreciated. Please provide the requested information by Wednesday, June 12, 1985. Messrs. Peter Stockton or Jeffrey Hodges of the Subcommittee staff are available to answer any questions that you and Mr. Adams may have. They can be reached on 225-4441.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:PScm

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

June 14, 1985

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
  and Investigations
Committee on Energy and Commerce
House of Representatives

RECEIVED
JUN 14 1985
Subcommittee on
Oversight and Investigations

Dear Mr. Chairman:

In your letter of May 28, 1985, you asked us to answer a number of questions concerning our April 24, 1985, testimony before your Subcommittee on defense contractors' overhead costs. This letter discusses each of the six points for which you requested additional information.

DEFENSE CONTRACT AUDIT AGENCY PROBLEMS

Based on my statement that "the Defense Contract Audit Agency (DCAA) has considerable problems and we have noted those problems," your letter requested a description of the nature of these problems together with supporting documentation. In this statement I was referring to the work we have recently completed on DCAA's operations for the Senate Committee on Governmental Affairs and the House Subcommittee on Legislation and National Security. We focused on (1) how effectively DCAA plans and implements its audit work and manages its resources and (2) the usefulness of DCAA reports.

Enclosed is our draft report entitled, Defense Contract Audit Agency Needs to Increases Its Management Oversight of Planning Operations and Reports (May 31, 1985). This draft points out that (1) inconsistencies in DCAA's planning system detract from its potential value and reduce assurances that DCAA is effectively managing its resources and (2) DCAA could improve its reports by providing more detailed support for its findings and a better explanation of its audit steps.

Our draft report recommends that the Secretary of Defense instruct the Director, DCAA, to assure that field audit offices adhere to DCAA's planning system in order to provide information which is reliable for approving work plans and managing resources. In addition, we stated that DCAA might well be served by further discussions with its customers on how its work and reports could be improved.

OUR PLANS TO EVALUATE DCAA EFFECTIVENESS IN DISCLOSING UNALLOWABLE CONTRACTOR COSTS

Your letter asked if we had plans to determine if DCAA is effective in disclosing unallowable costs in its contractor overhead audits. We testified that we could examine this issue on a case study basis.

As a result, we are planning to audit selected major defense contractors to compare DCAA's actual overhead audit results with the underlying records to learn if DCAA was able to discover the most significant questionable charges. As we testified, DCAA is not in a position to examine every voucher submitted by a contractor in its overhead submission and, as a result, DCAA must use statistical sampling techniques. As we testified, this is a high resource burden, but we believe that a case study audit to examine the effectiveness of DCAA's overhead audit coverage is warranted. We plan to begin our audit during the first quarter of fiscal year 1986.

ALLOWABILITY OF LEGAL FEES

You asked that we clarify our testimony with respect to the allowability of attorneys fees under the Federal Acquisition Regulation (FAR). There are two types of legal costs--those that result from efforts performed by company employees and those services rendered by outside legal counsel.

In-house legal costs (with some specific exceptions such as those incurred in connection with the defense of fraud proceedings, FAR 31.205-47, and organization or reorganization efforts, FAR 31.205-27) are allowable to the extent they are allocable and reasonable. FAR 31.204. We find no provision in FAR which specifically makes unallowable the in-house legal costs of prosecuting claims before the Armed Services Board of Contract Appeals (ASBCA). The FAR provision (discussed below) that mentions prosecuting claims before the ASBCA does so only in connection with legal services by individuals "who are not officers or employees of the contractor".

Subject to certain conditions and exclusions, FAR 31.205-33 "Professional and Consultant Service Costs" allows the costs of professional services, including legal services, rendered by outside counsel when those costs are reasonable in relation to the services rendered and when not contingent on recovery of costs from the government. Of particular interest here are the exclusions of subsection (d) which, in part, provides that the costs of outside legal services and directly associated costs incurred in connection with "the prosecution of claims against the Government are unallowable." Pursuant to subsection (d) a contractor is not permitted to claim as allowable the costs of employing outside legal services for representation before the ASBCA that are incurred in connection with "the prosecution of claims against the government."

We are aware that McDonnell-Douglas Corporation attempted to charge the government with substantial legal fees arising from litigation with Northrop Corporation and that the Navy has refused to pay those fees. We have no opinion on how this matter will ultimately be resolved since resolution may hinge on facts and other matters of which we have no knowledge. Similarly, we have no basis for an opinion on the establishment of a dollar ceiling on otherwise allowable legal fees that can be charged by contractors to the government. FAR 31.205-33, however, already conditions the allowability of outside legal services on their reasonableness in relation to the services rendered.

FALSE CLAIMS

Your question refers to my statement that "18 U.S.C. § 1001 requires a provision in each contract that holds the contractor to not submitting false claims in the first instance." To be more precise, 18 U.S.C. § 1001 is a statute of general application that can apply to a variety of circumstances, including those arising from the submission of information in connection with a government contract. Specifically, 18 U.S.C. § 1001 states:

> "Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both."

With respect to the application of 18 U.S.C. § 1001 in connection with the submission of a contract claim, two elements of any violation of 18 U.S.C. § 1001 are the making of (1) a false statement with (2) a fraudulent intent, that is, "knowingly and willfully." A determination whether in any given case such elements can be established is fact dependent. Since we do not possess (nor are we necessarily the most appropriate party to develop) the necessary facts, we are not in a position to express an opinion whether the individual submitting claims covering personal trips by General Dynamics officials knowingly and willfully committed a proscribed act.

As a more general matter, it has been held that a defendant cannot be convicted under 18 U.S.C. § 1001 for a statement or billing which is accurate within a reasonable construction of its contract. United States v. Race 632 F.2d 1114, 1120 (4th Cir. 1980.) Applying the rationale for this rule in a situation involving an ambiguous regulation rather than a contract could very well result in the same conclusion. In my testimony, I urged a clarification of ambiguous regulations that lend themselves to differing, but reasonable, interpretations. I believe that the foregoing provides one more reason for doing so.

CONTRACTING OFFICER AND AUDITOR DETERMINATION PROCEDURES OF FINAL INDIRECT COST RATES

You requested that we clarify the distinction between contracting officer and auditor determination procedures with respect to establishing final indirect cost rates. You also requested our views on possibly eliminating this distinction.

Final overhead rates at government contractor locations are determined in two ways: (1) by contracting officer determination procedure (FAR 42.705-1) and (2) auditor determination procedure (FAR 42.705-2). In essence, the contracting officer determination procedure is to be followed when the contractor's activity is a segment. That is, one of two or more divisions of a company or any business activity large enough to have an Administrative Contracting Officer (ACO) in residence. The auditor determination procedure is to be used in determining final overhead rates for any activities not covered by ACO determination. Because ACOs are generally placed in residence at the larger contractor segments, this generally results, as indicated in your letter, in small contractors having auditor determination procedures.

The Defense Acquisition Regulation (DAR) in 1978 (DAC 76-16, 1 August 1978) stated that determining final overhead rates by procurement (ACO) would be the basic policy and that exceptions could be made in special circumstances where the ACO and the auditor could agree that:

1. The contractor location was involved primarily with fixed-price work.
2. The contractor segment has a history of no disputes or cost problems.
3. The administrative cost of procurement determination is in excess of the benefits it would provide.

4. It is agreed that other special circumstances dictate the deviation.

The current FAR, subpart 42.7 "Indirect Cost Rates" continues the final overhead rate determination concepts established by DAR.

We have not performed specific audit work on the question of the benefits of determining indirect rates by audit determination as opposed to ACO determination. We have reviewed a report on this subject prepared by the staff of the House Armed Services Committee presented to a joint hearing of the Subcommittee on Sea Power and Strategic and Critical Materials and the Subcommittee on Investigations dated May 15, 1985. Our auditors and DCAA auditors assisted in this study of indirect cost settlements at 31 defense contractor segments and reviewed the final overhead settlements of the 31 contractor segments. Eight segments were audit determined. Six of those eight settlements had a sustention rate of 100 percent. The sustention rate for all eight was 88 percent. ACO determination procedures were used for the remaining 23 segments and the amount of costs sustained as unallowable was 60 percent.

It is important to note that under FAR, if the auditor and contractor do not reach agreement under auditor determination procedures, the cognizant contracting officer still has the final responsibility for resolving the disagreement. The same amount of audit work must be accomplished by DCAA in either case. Therefore, if the sustention ratio demonstrated by the House Armed Services Committee report is representative for all overhead determinations, a substantial savings to the government could be achieved by an exclusive audit determination approach. We believe that the Department of Defense (DOD) should consider such an approach.

CONTRACTING OFFICER DOCUMENTATION OF NEGOTIATIONS

According to our testimony, we indicated that we had written to DOD stating that ACOs should document their negotiations with contractors. Your letter requests that we furnish copies of our correspondence with DOD on this matter.

In our testimony, we were referring to our report to the Secretary of Defense which was in draft as of the date of our testimony. This report was issued on May 7, 1985, and it recommended that the Secretary of Defense

> "Direct administrative contracting officers to negotiate, settle, and document costs questioned as unallowable by DCAA on overhead claims on an item-by-item basis." (Underscoring added).

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Although DOD has yet to respond to this recommendation, we fully expect that it will respond before the 60-day period lapses. We will provide DOD's response to your Subcommittee.

We hope that this information is responsive to your concerns. Please advise us if further information is required.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Enclosure

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS
DASD(P)(CPF)

18 SEP 1985

Mr. Frank C. Conahan
Director
National Security and International
  Affairs Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) letter report entitled, "Improvements Needed in Department of Defense Procedures to Prevent Reimbursement of Unallowable Costs on Government Contracts" dated May 7, 1985 (GAO Code 396107)--OSD Case No. 6747. This is the second report based on a 1984 review of Administrative Contracting Officers (ACOs) final overhead cost settlements at 12 major DoD contracting activities.

The report on the review at the 12 contracting activities, dated October 29, 1984, recommended that Federal Acquisition Regulation (FAR) criteria for cost of advertising and selling be clarified to reduce ambiguities surrounding these costs; and that the FAR specifically address the circumstances under which costs for air shows, exhibits, displays, promotions, models and giveaways will be considered allowable or unallowable. The Department concurred with those recommendations. Changes to the FAR are now being circulated for comment and should be incorporated into the regulation in the very near future.

The recommendations contained in your May 7th report are: (a) that FAR section 31.205 be amended to state that costs made specifically unallowable under any subsection of FAR 31.205 are not allowable under any other subsections of FAR 31.2., and (b) that Administrative Contracting Officers be directed to negotiate, settle, and document costs questioned by the Defense Contract Audit Agency on overhead claims on an item-by-item basis. The DoD concurs with recommendation one and partially concurs with recommendation two.

The enclosure provides DoD's detailed response to the findings and recommendations contained in the letter report.

Sincerely,

James P. Wade
James P. Wade, Jr.

Enclosure

GAO LETTER REPORT NO. GAO/NSIAD-85-81 - DATED MAY 7, 1985
(GAO CODE NO. 396107) - OSD CASE NO. 6747

"IMPROVEMENTS NEEDED IN DEPARTMENT OF DEFENSE PROCEDURES TO PREVENT REIMBURSEMENT OF UNALLOWABLE COSTS ON GOVERNMENT CONTRACTS"

DEPARTMENT OF DEFENSE COMMENTS

FINDINGS

- **FINDING A: Proposed Changes To Federal Acquisition Regulation Is A Positive Step But Does Not Go Far Enough.** In a previous report (OSD Case 6576), GAO found numerous instances where the Defense Contract Audit Agency (DCAA) was challenging significant amounts of contractor overhead costs as unallowable expenses. GAO also found that the Administrative Contracting Officers (ACO) were overruling DCAA and allowing a large percentage of these questioned costs. At the same time, GAO also found that ambiguities in the Federal Acquisition Regulation (FAR) cause contractors, DCAA and the ACOs to have different interpretations on allowability. GAO then concluded that the system DoD uses to prevent reimbursement of unallowable costs on government contracts could be improved by clarification of the FAR to eliminate the ambiguities. GAO was pleased to note, in this report, the circulation for comment of a proposed FAR change which GAO concluded should eliminate much of the confusion concerning these costs. The proposed change, according to GAO would prevent unallowable "Advertising Costs" (FAR 31.205-1) from being made allowable under other subsections of FAR 31.2. However, GAO pointed out there are costs, other than public relations and advertising, which may be made unallowable by one subsection but allowed into the negotiation process by another subsection. GAO concluded that the proposed change did not go far enough. GAO further concluded, therefore, that the FAR should be amended so that any cost made unallowable under any subsection of FAR 31.205 "Selected Costs" cannot be allowable under any other section of FAR 31.2. This change, GAO finally concluded, would reduce differences and disagreements among contractors, DCAA, and ACOs; improve overhead negotiations; and reduce inconsistent treatment of costs under FAR 31.205. (pp. 1-4, GAO Letter Report)

RESPONSE: DoD concurs. During the past couple of years the Department has reviewed a number of cost principles and attempted to eliminate ambiguities and loopholes whenever they were discovered. The Defense Council on Integrity and Management Improvement (DCIMI) decided, at its June 5, 1985 meeting, that a task force should be formed to review all cost principles for ambiguities and loopholes. The task force has been formed and a proposed action plan has been submitted to the Deputy Secretary of Defense. (See also the response to Recommendation 1.)

o **FINDING B:** Contracting Officers Should Be Required To Settle Items Of Cost Questioned On An Item-By-Item Basis. GAO found that contractors and ACOs are reluctant to negotiate and agree to items of cost questioned by DCAA on an item-by-item basis. According to GAO, this reluctance apparently results from knowing that once an item of cost is mutually agreed to as unallowable, it would have to be excluded from any billing, claim or proposal applicable to a government contract. GAO concluded that by agreeing to a compromise figure in total (usually a 50/50 split), without addressing specific items such as air shows, entertainment, or giveaways, contractors can continue, year after year, to keep these costs in the overhead proposal for bottom line negotiations. GAO further concluded that a requirement for ACOs to identify, document and settle individual items of cost questioned as unallowable in overhead settlements would contribute to the effectiveness of Cost Accounting Standard (CAS) 405 "Accounting For Unallowable Costs" and would represent a major step forward in preventing reimbursement of unallowable costs on government contracts. GAO additionally concluded that the settlement of each cost item should be agreed to by both parties before the final overhead settlement is completed. (pp. 2, 4, GAO Letter Report)

RESPONSE: The DoD partially concurs. The DoD concurs that compromise settlements should not be completed in the aggregate without addressing individual cost items. The FAR currently requires that the Price Negotiation Memorandum (PNM) (a) cover significant matters in the advisory audit report, (b) include a reconciliation of all costs questioned, identify items and amounts allowed or disallowed in the final settlement, and specify how allocability issues were dispositioned, and (c) set forth the reasons why any recommendation of an auditor or other advisor was not followed. The DoD, however, does not concur that both parties should necessarily agree to each cost item before a final overhead settlement is completed. There will continue to be contract negotiations where the contractors can make a case for at least part of an expenditure. Ambiguities have contributed to this situation in the past and current efforts should help alleviate these situations in the future, but the DoD will have to continue to handle settlements involving contracts initiated under the previous FAR requirements. In addition, the FAR can never resolve completely all financial and accounting issues involved in contract settlements. Therefore, a requirement that the Government and the Contractor agree on each cost item likely would result in more protracted negotiations and litigations. It also likely would increase the Government's cost on some contracts. Such situations would not be in the best interest of the Government. The current policy of requiring the individual costs to be addressed and documented in the PNM, but leaving the contracting officer the flexibility to negotiate final settlements that are in the best interest of the Government is an appropriate policy and should be continued.

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Defense Acquisition Regulatory Council to coordinate with the Civilian Agency Acquisition Council to amend FAR section 31.205 to state that all costs made specifically unallowable under any subsection of FAR 31.205 are not allowable under any other subsections of FAR 31.2. (p. 4, GAO Letter Report)

DOD RESPONSE: DoD concurs. Coordination with the Civilian Agency Acquisition Council will begin immediately. The Assistant Secretary of Defense (Acquisition and Logistics) will forward a proposed FAR case to the Defense Acquisition Regulatory Council within 30 days. In addition, the Defense Council on Integrity and Management Improvement (DCIMI) has directed the establishment of a task force to review all cost principles (FAR Part 31) for ambiguities and loopholes. Terms of reference and milestones for completion of the review have been developed and were submitted to the Deputy Secretary of Defense on July 1, 1985. Based on the results of the task force effort, additional FAR changes may be made.

- **RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense direct administrative contracting officers to negotiate, settle and document costs questioned as unallowable by DCAA on overhead claims on an item-by-item basis. (p. 4, GAO Letter Report)

  DOD RESPONSE: DoD partially concurs. DoD does not agree that, in every case, individual elements of questioned costs should be negotiated and settled on an item-by-item basis. (See DoD response to Finding B) DoD does, however, agree that each element of cost, whether questioned or not by the auditor, should be thoroughly discussed and tracked to the negotiated amount in the Price Negotiation Memorandum. The DCIMI has tasked the Assistant Secretary of Defense (Acquisition and Logistics) to require the Military Departments and the Defense Logistics Agency (DLA) to prepare instructions that require pre- and post negotiation memoranda to include a statement of the derivation of positions for each cost element and a track to the negotiated amount for each element. A memorandum was signed by the Assistant Secretary of Defense (Acquisition and Logistics) on June 18, 1985, requesting the Military Departments and DLA to issue implementation instructions to require documentation in price negotiation memoranda by cost elements and to identify directed actions affecting the procurement.

Mr. **Dingell.** The Chair announces that our next witness will be Mr. Joseph H. Sherick, Inspector General, Department of Defense.

Mr. Sherick, we thank you for being with us. You will come forward and we will proceed to swearing you as a witness.

Mr. Sherick, do you have any objection to testifying under oath?

Mr. **Sherick.** No, sir.

Mr. **Dingell.** Do you desire to be attended by counsel?

Mr. **Sherick.** No, sir.

Mr. **Dingell.** Mr. Sherick, for your assistance and for your advice and information as to the powers of the committee, and your rights under the Constitution and laws and rules of the House, you will observe that copies of the rules of the House and rules of the committee and rules of the subcommittee are there before you in the red and white book.

If you have no objection to being sworn, if you will please stand and raise your right hand.

[Witness sworn.]

Mr. **Dingell.** Mr. Sherick, we thank you for your assistance to the committee. You may consider yourself recognized for such statement as you choose to give.

If you desire to be assisted in your presentation by members of your staff, that is perfectly appropriate. If they wish to testify, we will make the appropriate decision as to whether or not they will be sworn.

Mr. **Sherick.** I might later ask them, but as of right now, it's just me.

Mr. **Dingell.** Very well. You are recognized.

TESTIMONY OF JOSEPH H. SHERICK, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. **Sherick.** Good morning. I am Joe Sherick, inspector general of the Department of Defense, and I am pleased to appear today to discuss the role of the Defense Inspector General in auditing and investigating and, where appropriate, prosecuting defense contractors.

Since I have not previously appeared before this committee, I prepared a statement that goes into the inspector general responsibility in some detail. I would like, with your permission, to put the full statement in the record, and highlight key portions of the statement for you as I go through it.

Mr. **Dingell.** Without objection, your full statement will be inserted into the record and you will be recognized for such additional comments as you choose.

Mr. **Sherick.** The Department of Defense inspector general was established in September 1982 as a provision of the fiscal year 1983 Defense Authorization Act. I became Inspector General on May 20, 1983, almost 2 years ago. Prior to being designated IG, I served from June of 1981 as Assistant to the Secretary of Defense for Review and Oversight, an administratively created predecessor position to the IG.

Prior to that time, Mr. Chairman, I have been a career civil servant and I have 40 years Government experience.

The organization, statutory responsibilities and resource control authority of the Defense IG is different from other statutory IG's, in that it recognizes the IG's oversight authority over all audit and investigation programs and activities of the Department, but does not provide the IG direct control over all of the Department's audit and investigative resources.

There are 19,300 personnel in the Department of Defense audit, inspection and investigation activities. As you heard earlier this morning, there are another 2,000 GAO people who are involved in reviews of the Department of Defense. The IG has direct supervision over about 1,100 of these people, or about 5 percent.

This DOD-unique allocation of oversight resources reflects congressional recognition of the special oversight responsibilities of each of the service Secretaries for single service programs and day-to-day contractor activities.

To fully understand the IG oversight responsibility, some understanding of the size of Defense programs and activities is important. The DOD spends about $600 million each and every day of the year—Saturdays, Sundays, and holidays. It has 5,500 installations or activities located in the United States and 21 countries around the world. It employs about 8 million personnel around the world, including military personnel, civil servants, foreign nationals and defense industry employees.

It has over 4 million catalogued items in inventory, and in 1984 DOD placed 15 million individual contracts worth $146 billion involving over 60,000 prime contractors and hundreds of thousands of other suppliers and subcontractors. In fiscal year 1983, 22 individual contractors each did a billion dollars or more of business as prime contractors with the Department of Defense. Over 100 did $100 million or more.

The Office of the Inspector General is organized into six suboffices, each responsible for carrying out a specific portion of the inspector general's assigned responsibility.

The Assistant Inspector General for Auditing audits those programs and activities of the Department of Defense designated for audit by the Secretary of Defense and the IG. This organization specializes in audits of multiservice programs and of programs that are systemic in nature, with general application within the Department. He issues about 140 audit reports each year. He is also responsible for the central coordination of all internal audits by DOD internal audit agencies and GAO, in order to assure adequate coverage of DOD programs and avoidance of duplication.

The Assistant Inspector General for Audit Followup ensures prompt resolution and corrective action on all internal audits and provides oversight of resolution and disposition of contract audits. This office performs followup on all inspector general and General Accounting Office reports and monitors followup on audits by the military service audit agencies.

Our followup system is currently tracking over 2,100 internal audit reports, with over 6,700 recommendations. It also tracks action on over 10,000 open contract audit reports.

The Assistant Inspector General for Audit Policy and Oversight establishes DOD audit policy and oversees the implementation of contract and internal audit policy, as well as the performance of all audit and internal review organizations within the Department.

The Assistant Inspector General for Investigations investigates criminal violations, including major procurement and contract fraud, corruption, bribery, and major thefts.

The Assistant Inspector General for Criminal Investigation Policy and Oversight establishes departmental criminal investigative policy and oversees the performance of all criminal investigative agencies within the Department of Defense.

The Assistant Inspector General for Inspections evaluates efficiency and compliance with regulations of the specialized defense agencies such as the Defense Logistics Agency, DOD Dependent Schools, Defense Investigative Service, and others. He also conducts special inquiries of waste, abuse or other improper conduct which do not warrant an audit or a criminal investigation.

Last year DOD internal audit organizations issued over 18,000 reports with potential monetary benefits of over $2.7 billion. In the same period, DOD contract audit organizations issued over 61,000 audit reports with net savings of over $7.4 billion.

While the IG, DOD has only 5 percent of all the audit resources in DOD, it has a unique responsibility not only to perform actual audits, but to set policy for and perform oversight of the operations of all DOD auditors. The Department of Defense has 13 separate internal and contract audit organizations. In addition to the Defense Contract Audit Agency, which is by far the largest audit organization, each of the military departments has its own audit organization, and they also have internal review organizations at installations. Consequently, 12 of the 13 audit organizations in the Department of Defense are not a part of the IG.

The DCAA is under the direction and control of the DOD Comptroller. When the IG, DOD was established, the Secretary of Defense was directed to transfer not less than 100 positions to the inspector general to be filled by persons trained to perform contract audits.

These auditors were not to be used to do contract audits as performed by DCAA. The Congress provided the IG with a contract audit capability to: One, provide the manpower and technical expertise to oversee and review the work of DCAA, and two, to provide the inspector general flexibility and resources in situations where he deems it necessary or appropriate to look at entire procurements—the performance of defense contractors as well as the performance of Defense personnel. This reinforced the IG's ability to breakthrough the artificial barrier previously existing between internal and contract auditing.

The primary purpose of oversight reviews is to monitor and evaluate the adherence of defense auditors to established standards, policies, and procedures. The objectives of these reviews are to determine whether established auditing standards and policies are incorporated in formal agency regulations and complied with in the performance of audit work.

The auditing standards deal with such areas as auditor qualifications and training, ability of auditors to perform independent and objective audits, planning of audits, documenting audit work, and reporting of audit results.

Oversight reviews of DCAA have included reviews of their access to records, reporting of fraud or illegal acts, adequacy of defective pricing audits, coverage of subcontractors' pricing proposals, operations audits, and effectiveness of mobile incurred cost audits.

We reviewed DCAA policies and practices in addressing denials of access to contractors' records in 1983. Our review showed that access problems of varying degrees were encountered by DCAA auditors in most of the locations visited. We concluded that more aggressive action and improved controls were required by DCAA in obtaining contractors' records necessary for full audit coverage.

The DCAA has advised us that significant improvements have been made in their action to resolve access problems. They have become more aggressive in insisting that relevant records needed for their reviews are provided by contractors, and we are pleased with the progress made by DCAA to date, but plan a follow-up review some time within the next 12 months to ensure that the correction of access to records really has been improved.

On reporting contractor fraud, the DCAA auditors are charged with being alert for fraud or irregular conduct during their audits and expand the audit scope when needed. These reports must be issued promptly, if the investigative organizations are going to be able to move in on a suspected crime.

We performed a review of this responsibility in 1983 to evaluate the timeliness of DCAA actions, management control over referrals, and the effectiveness of reporting. We found in some cases untimely referrals, improper disclosures to procurement officials, failure to refer irregular conduct, and inadequate controls to assure timely referral.

Our current followup review shows that DCAA has taken corrective action and shown major improvement in this area. Fraud referrals by DCAA have risen nearly fivefold, increasing from 26 in fiscal year 1981 to 39 in 1982, 60 in 1983, and 125 in 1984.

To date, in fiscal year 1985, DCAA has referred 77 suspected fraud cases.

The assistant IG for auditing has about 450 auditors, and devotes about 60 percent of his audit man-days to the acquisition programs. I have three audit groups that have been established to pursue our audit responsibilities in the procurement area. These include the major acquisition group. This group focuses on requirements, costs, and acquisition strategy of individual major systems or families of systems.

The contract audit group provides DOD management and independent evaluation of the efficiency with which defense contracts are administered and managed. It consists of five teams, staffed with auditors experienced in doing contract audit work.

Two recent audit reports on progress payments and aircraft engine spare parts pricing reported potential savings of over $438 million.

The last group is the acquisition support group, and like acquisition support implies in its title, this group has a cross-service responsibility to look at acquisition organizations and entities as they relate to policies and programs.

We look at, for instance, the research and development portion of acquisition across the board. Test facilities, the laboratory system, ranges including the Supersonic sled tracks.

We look at contract administration, the organizations, the Defense Contract Administrative Services, their training, adequacy of staffing and how offices perform their assigned responsibilities.

We look in the procurement area at the buying activities. These are the Army Commodity Commands, Navy Aviation Supply Offices, Ship Parts Control Center, and Air Logistics Centers, to determine the reasonableness of prices paid for spare parts, the procedures used to buy spares, and so forth.

An example of the work this group does is our followup on a DOD-wide audit on the procurement of spare parts which will determine the impact of the recent DOD initiatives to improve spare parts acquisition. A recently completed quick-reaction report by this group included component breakout by the U.S. Army Missile Command, breakout of Tow missile and Pershing missile items. This group also recently issued reports on defective parts on the Navy's LAMPS system, and the breakout of high dollar value helicopter parts by the Naval Air System. These three reports identified potential savings of almost $10 million.

In the last 2 years my auditors have completed nine audits and issued nine reports which either directly or indirectly involved the General Dynamics Corp.

In some cases the audits involve weapons systems being built by that corporation. In other cases we selected General Dynamics as one of the several defense contractors to be reviewed in a general study of a given aspect of DOD contract administration.

In addition to the nine completed audits, there are 13 ongoing audit projects that directly or indirectly involve the General Dynamics Corp. both of which are built in part by General Dynamics, and we are auditing the Trident submarine which is a General Dynamics program.

The inspector general responsibility for DOD criminal investigations is threefold:

He conducts criminal investigations directly through the assistant inspector general for investigations, who heads the Defense Criminal Investigative Service, which is under the IG. He provides investigative policy to all criminal investigative organizations, and he oversees the criminal investigation services including those investigations conducted by the Army, Navy, and Air Force.

When the IG, DOD was established, Congress decided to leave the military investigative organizations—the Army Criminal Investigative Command, the Naval Investigative Service, and the Air Force Office of Special Investigations—in their respective military departments. Currently in DOD there are 5,968 people assigned to the DOD criminal investigation organizations, of which 3,629 are criminal investigators.

Of the 3,629 criminal investigators, 161 are assigned directly to the IG, DOD. In addition to the oversight role, the Inspector General Act also permits the IG to request the military criminal investigative organizations to conduct investigations into allegations of particular interest to him. I have made numerous such requests both to the Army, Navy, and Air Force.

It should be pointed out that, in addition to contract fraud, these other criminal investigative organizations have a broad range of other serious crimes to investigate, including narcotics violations, thefts, arson, vandalism, murders, rapes, assaults and other crimes of violence which occur on military bases. Furthermore, the Navy and Air Force criminal investigative agencies have significant responsibilities regarding foreign counterintelligence.

I estimate that there are about 750 fraud trained criminal investigators in DOD at present. We have recommended adding an additional 400 over the next 3 years.

My office also serves as the primary DOD contact between the defense criminal investigative organizations and the investigative offices of the Department of Justice, including the Defense Procurement Fraud Unit.

With respect to the role of my office in the development of criminal investigative policy, I should note that virtually no such DOD-wide policy existed when I became inspector general. In the past 2 years we have therefore concentrated our effort in developing policies such as the following:

Investigative and prosecutive jurisdiction between DOD and DOJ. This was resolved in a memorandum of understanding between each department, recognizing the FBI's role and our role in all criminal investigations.

Investigative responsibilities among DOD criminal investigative organizations, between the Army, Navy, Air Force and my investigators, and the responsibility for joint investigations.

The issuance of IG subpoenas. The Inspector General Act gave us the authority to issue subpoenas, and I have used that throughout the Department, involving all investigations or audits that I feel are my responsibility, and have so determined.

The use of search warrants; coordination of remedies in fraud cases; access to records; investigative report format; criminal investigative analysis, trend and vulnerability analysis.

In addition, we have conducted a number of oversight projects designed to identify areas where improvements may be required. These include such areas as: Suspension and debarment actions; proactive operations by DOD criminal investigative organizations; adequacy of fraud agent strengths.

My office has also placed great significance on enhancing the awareness of DOD investigative personnel to the indicators of fraud. In this regard, we have conducted 15 5-day contract fraud training seminars which have provided advanced contract fraud training to over 500 defense criminal investigators.

I also believe that it is essential for procurement personnel to be sensitive to fraudulent schemes by Government contractors. Historically, the majority of contract fraud cases are discovered by contracting officers. Therefore, these officials must be aware of contract fraud indicators and the need to report such information to auditors and investigators.

In this regard, we have prepared a handbook on contract fraud indicators which has been distributed to over 50,000 DOD procurement, audit and investigative personnel.

My office has also conducted over 375 fraud training sessions for 18,000 procurement personnel. This is in addition to 6,400 fraud training sessions which were provided as part of our prevention program to 240,000 DOD management officials by criminal investigators assigned to the military departments.

My office has also issued 14 fraud awareness letters to DOD personnel, highlighting specific fraudulent schemes affecting DOD procurement.

These letters are designed to sensitize procurement personnel and to encourage the reporting of possible violations of law. This covers areas such as cost mischarging, shoddy materials, pay and allowance fraud, travel fraud and medical fraud.

Our commitment to the improvement of fraud awareness has moved outside of DOD. We have developed training materials to be used by trade associations and contractors to assist in identifying to their members and employees the type of procurement fraud which we will be investigating and will be prosecuted by the Government. This is an awareness and prevention effort as it applies to all levels of suppliers, including prime contractors, as well as various levels of subcontractors. We want them to know that we are here and we are not going to go away, and if they are cheating the Department of Defense, we are going to get them and they are going to go to jail.

In addition to these efforts, my office has recently completed a review of suspension and debarment authorities within DOD. Under the Federal acquisition regulation, the DOD has the right to protect itself from contractors which cannot adequately demonstrate their responsibility as government contractors.

My office was concerned that DOD was not taking adequate suspension and debarment action in contract fraud cases because of a lack of coordination between criminal investigators and procurement officials.

Our report, which was fully endorsed by the Department officials, identified numerous weaknesses in the system. As a result of our report, the Department now has an effective procurement remedy in this area. For example, in 1984 DOD suspended or debarred 454 contractors compared with 79 in 1980.

The Inspector General Act recognized, as I mentioned earlier, in performance of the duties assigned by the act, the inspectors general would encounter situations where they would need access to various types of documents in the possession of non-Government entities.

To meet this need, the act authorized the inspector general to require by subpoena the production of any documents or information necessary in the performance of functions assigned by the act.

Since September 1983, I have issued 110 subpoenas in various matters in discharge of my responsibility. For the most part, the subpoenas related to inqueries in the area of procurement, bribery of Government employees, and conflicts of interest.

To date we have only one instance in which we found it necessary to seek enforcement of a subpoena by seeking the order of a United States district court, and that case is in the court right now. It involves Westinghouse Corporation, and I testified in Pittsburgh. I think that the judge is going to ask for more witnesses.

Mr. **Dingell**. The judge is going to ask for more what?

Mr. **Sherick**. More witnesses.

Mr. DINGELL. Before he issues a subpoena?

Mr. SHERICK. No, no, I issued the subpoena. He is enforcing the subpoena.

Mr. DINGELL. Why is he going to ask for more witnesses?

Mr. SHERICK. He felt that he wanted to talk to Mr. Starrett of the Defense Contract Audit Agency before he made his final decision.

This was a discovery proceeding, and it's a very important case.

Mr. DINGELL. As a matter of fact, isn't this looking for documents that the Government paid to produce?

Mr. SHERICK. Absolutely. That's why I issued a subpoena.

Mr. DINGELL. I applaud your action. I am curious about the judge's.

Mr. SHERICK. Well, the judge is 88 years old. He was appointed under Franklin D. Roosevelt. He is a very astute individual who I feel wants to go into all the facts so that he is not overruled. In Pittsburgh, I was represented by a Department of Justice lawyer; Westinghouse was there with three law firms.

Mr. DINGELL. Three law firms?

Mr. SHERICK. Three law firms; or two law firms and an in-house counsel.

Mr. DINGELL. I wonder how much money they paid to those three counsels.

Mr. SHERICK. I understood that they made $400 or $500 an hour.

Mr. DINGELL. How many lawyers did they have?

Mr. SHERICK. They had suits on that I had never seen.

Mr. DINGELL. You're talking about $500 suits or $1,000.

Mr. SHERICK. I'd say $800. I never saw suits like that. I buy mine at Penney's, but I'll tell you, I was looking for one that would fit me.

It is a very serious case. It is very important to me, and it is very important to the Department of Defense. It is very important to the IG effort. As I say, I think the judge is very, very competent, and he is doing a very good job. If he rules against me, I may change my opinion, but right now I think he is very astute.

Mr. DINGELL. What is the test of law that is required for the issuance of subpoenas? It's just that you have probable cause, isn't it?

Mr. SHERICK. That is right. Even a suspicion that there might be fraud, waste, or mismanagement, but I was challenged and that's the way it is.

I must say, that is the first one that I have been challenged on.

As the inspector general, I am also directly concerned with relations between DOD and the Department of Justice concerning fraud matters which are referred to the Department of Justice for both criminal and civil action. I believe DOD and DOJ must address fraud, particularly contract fraud, in a coordinated manner.

My office stimulated and supported the creation of the Defense Procurement Fraud Unit. This unit, comprised of DOD and DOJ attorneys and investigators, as well as DCAA auditors, is designed to act as a centralized coordination and prosecution authority for DOD cases. It allows all DOD cases nationwide to be screened for both criminal and civil prosecution potential.

My office also initiated the renegotiation of a memorandum of understanding between Department of Defense and Department of

Justice. The previous memorandum of understanding, which was 30 years old, did not provide adequate emphasis on procurement fraud or recognize current DOD organizations and problems.

The new memorandum of understanding permits the early evaluation of cases to determine prosecutive merit and to plan the investigation in such a way as to assure successful prosecution. It enables DOD criminal investigative organizations, along with the FBI, to pursue fraud cases in a professional, cooperative and hard-hitting manner.

Earlier I mentioned the training which we have provided to DOD personnel. My office has also provided Department of Justice prosecutors and investigators the same kind of training to sensitize them to the needs of DOD and to orient them to DOD procurement procedures, and to familiarize them with the impact on the Department of Defense and its mission of some of the criminal acts that are against the Department.

Generally, I believe the Department is in a much more capable position to deal with procurement fraud in DOD today than it was 2 years ago.

Working with both the Department of Justice and the FBI, we have increased investigative and prosecutive resources, improved referral procedures, provided enhanced level of training, developed more significant investigations, and seen an increase in the number of indictments and convictions.

For example, in fiscal year 1982, DOD obtained 27 indictments and 102 convictions.

In fiscal year 1984, we obtained 174 indictments and 181 convictions.

I also operate the DOD hotline which receives calls and letters from military, civilian personnel who report real or perceived instances of waste, fraud or mismanagement in the Department of Defense.

The types of complaints received by the hotline staff and referred for inquiry or investigation are broad. Callers provide information on fraud, operational mismanagement, theft, irregularities in procurement practices, waste and abuse of Government property or personnel.

The numbers of calls received by the Defense Department have varied over the past years. During fiscal year 1984, over 7,800 complaints were received, and we have received more than 3,900 complaints during the first 6 months of fiscal year 1985. This compares with fewer than 1,000 complaints in all of fiscal year 1980 More than one-third of all our calls and letters are substantive complaints worth investigating or examining in greater detail.

I would like to say a few words on contractor gratuities. The provision of gratuities by contractors to Government employees is a serious problem in Federal procurement. Despite the fact that such gratuities are prohibited by criminal law and by every DOD contract, the problem continues.

While the purchase of a drink or a meal may seem innocent at first examination, I believe that the toleration of such practices leads to increasing erosion in the integrity of the entire procurement process. We have identified many cases which began as a simple gratuity case and quickly evolved into bribery. In some cases the reason for the gratuity was to induce a contract inspector to look the other way while shoddy materials were provided on defense contracts, to provide inside information on bids, to specially handle certain types of contracts, et cetera.

Recognizing this problem, we have taken a variety of actions to alert DOD employees to the problems ensuing from gratuities.

We have engaged in hundreds of integrity briefings for DOD employees to alert them to the prohibition against gratuities and the need to report any incident to criminal investigators and contract administrators.

In July 1984, my office initiated a project to review the current policies of major DOD contractors in relation to gratuities. This review is designed to identify such incidents, and assess the criminal, administrative and contractual responses by DOD.

We are also meeting with major DOD contractors which are identified in the review to seek more positive statements of corporate policies regarding the provision of gratuities.

My office also recently completed a review of the DOD standards of conduct regulation and its implementation by the military departments.

We have issued a number of recommendations to the DOD general counsel who is rewriting the DOD regulations.

We also have had substantial success in enlisting the aid of DCAA in identifying incidents of gratuities. Previously it was DCAA's policy not to make a full inquiry into the circumstances surrounding gratuities when the costs were unclaimed by the contractors.

As a result of our review, DCAA is now referring any evidence they uncover relating to suspected gratuities to Government employees to a criminal investigative organization regardless of whether it was charged to the Government. It is still a gratuity, as far as we are concerned. It's a crime, and we want to know about it whether he charges us or not.

I know that the committee has expressed great interest regarding improprieties by General Dynamics regarding the shipbuilding contracts. As inspector general, I have been very much concerned with these improprieties and I have been actively involved in oversight of all criminal investigations of General Dynamics.

Currently, the Naval Investigative Service and the Air Force Office of Special Investigations, as well as my own Defense Criminal Investigative Service and the FBI, have ongoing investigations relating to General Dynamics. Most of these investigations are being conducted under the auspices of Federal grand juries, which greatly restricts the amount of information which can be disseminated to persons who are not agents of the grand jury. For this reason, I cannot comment in greater detail on such investigations.

In addition to these cases, at my request and at the request of the Navy, the Naval Investigative Service is currently conducting an investigation of gratuities which General Dynamics provided to naval officials. The results of the investigation relating to the Navy have been referred for consideration to the Navy Gratuities Board.

However, because the Naval Investigative Service investigation identified some non-Navy recipients of gratuities, I have directed my staff to conduct a full investigation of non-Navy DOD officials who received gratuities from General Dynamics.

Mr. Chairman, that concludes my statement. I'll be happy to answer any questions which you or the members of the subcommittee may have.

[Testimony resumes on p. 446.]

[Subcommittee correspondence and the prepared statement of Mr. Sherick follow:]

NINETY-NINTH CONGRESS

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U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

ROOM 2323
RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-4441

April 16, 1985

The Honorable Joseph H. Sherick
Inspector General
Department of Defense
The Pentagon
Washington, D. C. 20301

Dear Mr. Sherick:

The staff of the Subcommittee on Oversight and Investigations has been in contact with officials of the Department of Defense (DOD) regarding your forthcoming appearance before the Subcommittee on Oversight and Investigations. We will be advising you shortly of the date and other particulars concerning the hearing.

In advance of the hearing, it would be helpful to the Subcommittee if the following information would be furnished:

1. Copies of news releases from anywhere in the DOD regarding indictments, convictions and other indicators of success in the DOD's efforts to combat fraud, waste and abuse. Please include news releases from September 1982 to the present.

2. An organizational chart of the Office of Inspector General (OIG). Include a functional statement for each component of the OIG.

3. Please describe the purpose and function of the DOD Hotline. How many people are utilized to man the Hotline? What duties do these people perform? How many calls does the Hotline receive each month? What is the nature of these calls? Are all complaints investigated? Do you believe that all complaints should be investigated or should referrals for investigation be handled on a selected basis? Should information that is not used be entered into an information data base? In addition to the DOD Hotline, please identify any other Hotline-type operations that exists within the DOE. If applicable, furnish the same data as requested above.

4. How many DOD criminal investigators come under the IG's functional oversight? How many DOD criminal investigators report directly to the IG? Where in the DOD structure are all of these investigators located?

5. How many DOD auditors come under the IG's functional oversight? How many DOD auditors report directly to the IG? Where in the DOD structure are all of these auditors located?

6. How many attorneys are there in the DOD?

7. How many criminal investigators does the IG have in the Los Angeles, California area? How many defense contractors are in the Los Angeles area? Please provide data on the volume and nature of the work that these contractors perform for the DOD. Please provide data on the nature of the criminal investigations concerning these contractors, number of referrals to the Justice Department, number of convictions, and the number of cases where Justice declined to prosecute.

8. With respect to DOD instruction 5240.4 (effective July 28, 1983), provide all reports of "significant incidents" involving criminal investigations submitted to the IG pursuant to 5240.4 since July 28, 1983.

9. Please furnish a copy of the DOD publication, "Indications of Fraud in Department of Defense Procurement". How many copies of this publication have been printed? What was the cost of this publication? What is the purpose of this publication? To whom has this publication been distributed?

10. Please provide the IG's position on global settlements (where criminal, civil and administrative actions are handled together). Furnish copies of applicable reports, letters, and memoranda.

Please provide the above requested information by April 18, 1985. Peter Stockton or Jeffrey Hodges of the Subcommittee staff are available to answer any questions you may have. They can be reached at 225-4441.

Thank you for your cooperation.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

22 APR 1985

RECEIVED
APR 22 1985
Subcommittee on
Oversight and Investigations

Honorable John D. Dingell
Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in reference to your letter dated April 16, 1985, requesting information pertinent to your upcoming hearing.

The following information is provided as you requested in the same numbered order as listed in your letter.

1. Copies of press releases pertaining to DoD efforts to combat fraud, waste and abuse are enclosed at Tab A. We are also asking the Military Services to provide copies of news releases which may have been issued by their field activities. We have previously furnished your staff copies of press releases regarding the work of my office at a meeting between members of your staff and mine on April 16, 1985..

2. Previously furnished to your staff.

3. Information regarding the DoD Hotline was also previously furnished. We have asked the Military Services for the detailed information regarding their hotlines that you requested. We will forward that data to you as soon as it is available.

4. Previously furnished to your staff.

5. As of September 30, 1984, there were 8,392 military and civilian auditors in DoD audit organizations which come under my oversight responsibility. Approximately 466 of these auditors currently report to me. The breakdown of the remaining auditors is shown below:

Internal Audit - Army	767
Navy	536
Air Force	828
IG, DoD	466

Internal Review - Army	999
Navy	899
Other	100
Military Exchanges	98
Contract Audit - Corp of Engineers	73
Defense Contract Audit Agency	3,526
Total	8,392

Note: The above figures do not include administrative or support staff.

6. There are approximately 6,000 attorneys in DoD. Most of these attorneys are members of the Judge Advocate General Corps of the Military Departments and deal primarily with military justice matters.

7. I have sixteen criminal investigators in the Los Angeles area. Each of the Military Departments also has criminal investigators in the Los Angeles area. According to the Defense Technical Information Center, there are 1,746 Defense contractors in Los Angeles County. These contractors did $13.7 billion worth of business in 1984 with DoD. The contracts covered the entire spectrum of government work from maintenance to aircraft. We do not maintain statistics on criminal investigations by regional area.

8. We are gathering information on the reports of significant incidents which are made pursuant to DoD Instruction 5240.4.

9. The publication, "Indicators of Fraud in Department of Defense Procurement" was distributed primarily to the Army, Navy, Air Force, and the Defense Logistics Agency for their contract administration personnel. It was also provided to all other Defense agencies. The remaining questions were answered earlier.

10. Previously furnished to your staff.

I am also enclosing at Tab B the oversight reviews of the Defense Contract Audit Agency that your staff requested.

I hope this information will be helpful to you.

Sincerely,

Joe Sherick

Joseph H. Sherick
Inspector General

Enclosures

DEPARTMENT OF DEFENSE
OFFICE OF THE INSPECTOR GENERAL
WASHINGTON, D.C. 20301

(Criminal Investigations
Policy and Oversight)

16 APR 1985

MEMORANDUM FOR DAVE STEWART, PPRM

SUBJECT: Telephonic Request from Representative Dingell

In response to the above request, the following information is provided:

1. Number of criminal investigators in DoD who are under DoD IG oversight.

Army:	1,115
Navy:	972
Air Force:	1,604
DoD IG:	193
Total	3,884

2. Number of criminal investigators who report directly to DoD IG.

DCIS	181
AIG-CIPO	12
Total	193

3. Where are the other criminal investigators in DoD?

USACIDC
NIS
AFOSI

4 & 5. A copy of the Redbook is attached. To date we have distributed 52,000 of these books, at a total cost of $38,430, $.74 a copy.

6. The DoD IG actively supports global settlements. The only formal information we have written is contained in our attached report on Suspension and Debarment.

7. Attached is a listing of all referrals by the Defense criminal investigative organizations to DPFU.

Howard W. Cox

Enclosures

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

21 JUN 1985

RECEIVED
JUN 24 1985
Subcommittee on
Oversight and Investigations

Honorable John D. Dingell
Chairman
Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Based on your letter of April 16, 1985, requesting copies of all significant incident reports, my staff has carefully reviewed the 895 reports submitted from October 1982 to April 1985.

Most of these cases are outside the procurement area. In addition, many are not yet closed investigations. In light of these factors, and because I have already provided a list of open Department of Defense procurement related investigations of major contractors with my letter of June 14, 1985, I would suggest that providing copies of all 895 significant incident reports is neither useful for your purposes nor productive of Inspector General staff time. I would further note that most of the open investigations referenced in my June 14, 1985 letter were reported as significant incident reports. Accordingly, any production of information related to these significant incident reports would be largely duplicative of information already provided.

I am providing a copy of this letter to the Ranking Minority Member of the Subcommittee.

Sincerely,

Joseph H. Sherick
Inspector General

STATEMENT BY

JOSEPH H. SHERICK

INSPECTOR GENERAL

DEPARTMENT OF DEFENSE

Mr. Chairman and Members of the Subcommittee.

I am pleased to appear today to discuss the role of the Defense Inspector General in auditing, investigating and, where appropriate, prosecuting Defense contractors.

The Defense Inspector General was established in September 1982 as a provision of the FY 1983 Defense Authorization Act. I became Inspector General on May 20, 1983, almost two years ago. Prior to being designated IG, I served from June of 1981 as Assistant to the Secretary of Defense for Review and Oversight, an administratively created predecessor to the IG position.

The organization, statutory responsibility, and resource control authority of the Defense IG is different from other statutory IG's. It recognizes the IG's oversight authority over-all programs and activities of the Department but does not provide the IG direct control of all of the Department's audit and investigative resources. There are 19,300 personnel in DoD audit, inspection, and investigative activities. The IG has direct supervision over about 1,100 of these people or about 5 percent. This DoD-unique allocation of oversight resources reflects congressional recognition of the special oversight responsibilities of the Service Secretaries and the DoD Comptroller for single service programs and day to day contractor activity.

To fully understand the IG oversight responsibility, some understanding of the size of Defense programs and activities is important. The DoD spends about $600 million each and every day of the year--Saturdays, Sundays and holidays. It has 5,500 installations or activities located in the United States and 21 countries around the world. It employs about 8 million personnel around the world including military personnel, civil servants, foreign national, and defense industry. It has over 4 million cataloged items in inventory. In FY 1984, DoD placed 15 million contracts worth $146 billion involving over 60,000 prime contractors and hundreds of thousands of other suppliers and subcontractors. In FY 1983, 22 individual contractors each did a billion dollars or more of business as prime contractors with DoD, over 100 did $100 million or more.

HOW THE IG IS ORGANIZED

The Office of the Inspector General is organized into six suboffices, each responsible for carrying out a specific portion of the Inspector General's assigned mission.

Auditing

The Assistant Inspector General for Auditing audits those programs and activities of the DoD designated for audit by the Secretary of Defense and the IG. This organization specializes in audits of multi-Service programs and of programs that are systemic in nature with general application within the Department. He issues about 140 audit reports each year. He is also responsible for the central coordination of all internal audits by DoD internal audit agencies and GAO in order to assure adequate coverage of DoD programs and avoidance of duplication.

The Assistant Inspector General for Audit Followup ensures prompt resolution and corrective action on all internal audits and provides oversight of resolution and disposition of contract audits. This office performs followup on all Inspector General and General Accounting Office reports and monitors followup on audits made by the Military Service audit agencies. Our followup system is currently tracking over 2,100 internal audit reports with over 6,700 recommendations. It also tracks action on over 10,000 open contract audit reports.

The Assistant Inspector General for Audit Policy and Oversight establishes DoD audit policy and oversees the implementation of contract and internal audit policy as well as the performance of all audit and internal review organizations within the Department.

Criminal Policy and Investigation

The Assistant Inspector General for Investigations investigates criminal violations including major procurement and contract fraud, corruption, bribery, and major thefts.

The Assistant Inspector General for Criminal Investigations Policy and Oversight establishes Departmental criminal investigative policy and oversees the performance of all criminal investigative agencies within DoD.

Inspection and Special Inquiries

The Assistant Inspector General for Inspections evaluates efficiency and compliance with regulations of the specialized Defense Agencies such as the Defense Logistics Agency, DoD Dependent Schools, Defense Investigative Service, etc. He also conducts special inquiries of waste, abuse or other improper conduct which do not warrant an audit or a criminal investigation.

THE IG ROLES IN AUDITING

Last year, DoD internal audit organizations issued over 18,000 reports with potential monetary benefits of over $2.7 billion. In the same period, DoD contract audit organizations issued over 61,000 audit reports with net savings of over $7.4 billion.

While the IG, DoD has only 5 percent of all the audit resources in DoD, it has a unique responsibility not only to perform actual audits, but to set policy for and perform oversight of the operations of all DoD auditors. The DoD has 13 internal and contract audit organizations. In addition to the Defense Contract Audit Agency (DCAA), the largest audit organization, each of the Military Departments has its own audit organization, and there are several internal review organizations. Twelve of these 13 audit organizations are not a part of the IG.

The Defense Contract Audit Agency (DCAA) is under the direction and control of the DoD Comptroller. When the IG, DoD was established, the Secretary of Defense was directed to transfer not less than 100 positions to the Inspector General to be filled by persons trained to perform contract audits. These auditors were not to be used to do contract audits as performed by DCAA. The Congress provided the IG with a contract audit capability to (1) provide the manpower and technical expertise to oversee and review the work of DCAA, and (2) provide the Inspector General flexibility and resources in situations where he deems it necessary or appropriate to look at entire procurements--the performance of defense contractors as well as the performance of defense personnel. This reinforced the IG's ability to break through the artificial barrier previously existing between internal and contract auditing.

Contract Audit Policy

The Department has contract auditing policies and procedures set out in directives, instructions and policy memoranda, the Defense Supplement to the Federal Acquisition Regulations, and the DCAA Audit Manual (which has been in existence for many years). Contract auditors must also follow the auditing standards issued by the American Institute of Certified Public Accountants and the Comptroller General of the United States, and policies in Office of Management and Budget Circular A-73.

Because of the extensive policy guidance already in place, the IG has issued only two additional contract audit policy memoranda to date. This covered DCAA's participation in should cost studies and the coordination between DoD contract and internal auditors. I have focused most of my effort in the oversight area.

Contract Audit Oversight

The primary purpose of oversight reviews is to monitor and evaluate the adherence of Defense auditors to established standards, policies and procedures. The objectives of these reviews are to determine whether established auditing standards and policies are incorporated in formal agency regulations and complied with in the performance of audit work. The auditing standards deal with such areas as auditor qualifications and training, ability of auditors to perform independent and objective audits, planning of audits, documenting audit work, and reporting of audit results.

Oversight reviews of DCAA have included access to contractors' records, reporting of fraud or illegal acts, adequacy of defective pricing audits, coverage of subcontractors' pricing proposals, operations audits, and effectiveness of mobile incurred cost audits.

Access to Contractor Records

We reviewed DCAA policies and practices in addressing denials of access to contractors' records in 1983. The review covered the Government's fiscal years 1980 through 1983. Our objective was to determine whether DCAA was obtaining full access to contractors' records needed for audit accomplishment and whether access problems, when encountered, were resolved in a timely and effective manner.

Our review showed that access problems of varying degrees were encountered by DCAA auditors at most of the locations visited. Thirteen of 23 DCAA field offices cognizant of single contractors had experienced access problems and four contractors were denying records at the time of our visit. We concluded that more aggressive action and improved controls were required by

DCAA in obtaining contractors' records necessary for full audit coverage.

We recommended that DCAA take immediate action toward resolving the access problems at problem contractors. The DCAA agreed and subsequently met with contractor management to seek solutions to the denials. We have been informed that their efforts are meeting success.

We recommended that the Office of Under Secretary of Defense for Research and Engineering (OUSDR&E) revise the acquisition regulations to require that all price proposal audit reports be free of significant qualifications due to contractor denials and that all data submitted subsequent to the audit be provided to the auditors. The OUSDR&E subsequently agreed to strengthen the acquisition regulations to ensure that the contractor provides DCAA with the information necessary for their audits, including data submitted to the contracting officer after completion of their reviews.

To correct the problems concerning denials of records supporting incurred costs, we recommended DCAA strengthen their guidance to field auditors to instruct them to promptly suspend costs until the records are provided. The DCAA agreed, revised their policies, and is currently taking a more aggressive stance with contractors.

The DCAA has advised us that significant improvements have been made in their actions to resolve access problems. They have become more aggressive in insisting that relevant records needed for their review are provided by contractors. We are pleased with the progress made by DCAA to date and plan a followup review sometime within the next twelve months.

Reporting Contractor Fraud

The DCAA auditors must be alert for irregular conduct during their audits and expand the audit scope when needed. Reports of suspected fraud must be issued promptly.

We performed a review of this area to evaluate the timeliness of DCAA actions, management control over referrals, and the effectiveness of reporting. We found, in some cases, untimely referrals, improper disclosures to procurement officials, failure to refer irregular conduct, and inadequate controls to ensure timely referrals. Our recommendations included establishing a formal control system for field referrals, establishing a policy that all suspected irregular conduct be referred, requiring that brief written alerts for investigators be prepared prior to the preparation of formal irregular conduct reports, and ceasing the practice of discussing suspected improper conduct cases with procurement officials without investigative approval.

Our current followup review shows that DCAA has implemented a formalized system of controlling fraud reports, has issued revised guidance to their field auditors to issue brief written alerts to investigators and to cease discussing suspected improprieties until investigators have been notified. Fraud referrals by DCAA have risen nearly five-fold, increasing from 26 in FY 1981, to 39 in FY 1982, 60 in FY 1983, and 125 in FY 1984. To date in FY 1985, DCAA has referred 77 suspected fraud cases.

IG Audit Operations

The Assistant Inspector General for Auditing has 570 auditors and support positions authorized with 511 on board today. I have increased the amount of audit time devoted to the Defense acquisition process from about 10 percent of available mandays in 1981 to about 60 percent currently. My audit staff is organized to provide coverage of the entire DoD acquisition process, from formulation of requirements through disposal activities. During the course of many of our audits, it is often necessary to visit a contractor's facilities to acquire data required in our specialized audits. Contractors are notified well in advance of our visits by the contracting officer. Additionally, we notify the DCAA in writing of the contracts we plan to review and where possible, rely on them to provide us with audit support in order to avoid any duplication of effort. My auditors do require access to contractor records and operations and issue formal audit reports on their findings with recommendations.

Three audit groups have been established to pursue our audit responsibilities in the procurement area:

- Major Acquisition Group - This group focuses on the requirements, costs, and acquisition strategies of individual major systems or families of systems. It includes not only audit talent but engineers, technical experts, and cost analysts--in other words, the group has people with both an auditing and/or acquisition background. This group has completed audits on such systems as the Joint Service Advanced Vertical Lift Aircraft (JVX) Program, the DIVAD Gun, the A-6E Intruder Aircraft, and the Interim Upper Stage Boosters. These four audits alone reported potential savings of $159 million. The group is currently reviewing the Trident Submarine Program, the Commercial Utility Cargo Vehicle, the NAVSTAR Global Positioning Systems, and the P-3C Aircraft programs.

- Contract Audit Group - This group provides DoD management an independent evaluation of the efficiency with which Defense contracts are administered and managed. It consists of four teams staffed with auditors experienced in doing contract audit work. Two recent audit reports on Progress Payments and Aircraft Engine Spare Parts Pricing reported potential savings of over $458 million. Projects are ongoing in a number of areas, such as defective pricing, competition in subcontracting, and the Should Cost Program.

- Acquisition Support Programs Group - Like the "acquisition support" implies in its title--the auditors here are doing cross-Service reviews on a broad base of acquisition related policies and programs, such as:

- Research, Development, Test and Evaluation

  - -- Test facilities
  - -- DoD laboratories
  - -- Supersonic sled tracks

- Contract Administration
  - -- Defense Contract Administrative Services

- Procurement
  - -- Buying activities (e.g., Air Logistics Centers, Army Depots, Navy Aviation Supply Office or Ship Parts Control Center)

An example of the work this group does is our follow-on DoD-wide Audit on the Procurement of Spare Parts, which will determine the impact of the recent DoD initiatives to improve the acquisition process for spares. A recently completed project included an audit on Supersonic Sled Tracks, which yielded $52 million in potential savings. This group also is responsible for performing time critical acquisition audits on which we issue quick-reaction reports, if necessary, to deter waste in the Department. Recently completed quick-reaction reports include component breakout at the U.S. Army Missile Command, defective parts on the Navy's LAMPS MK III program, and breakout of high-dollar-value helicopter parts by NAVAIR. These three reports identified potential savings of almost $10 million.

Audits of General Dynamics

In the last two years, my auditors have completed nine audits and issued nine reports which either directly or indirectly involved the General Dynamics Corporation. In some cases, these audits involved weapon systems being built by the corporation. In other cases, we selected General Dynamics as one of several Defense contractors to be reviewed in a general study of a given aspect of DoD contract administration.

For instance, we recently issued a quick-reaction report alerting the Navy not to use as a basis of negotiation the decrement factor developed by Electric Boat to determine the anticipated difference between prices initially quoted by subcontractors for material and the prices eventually negotiated. Our audit concluded that the company consistently underestimated the amount of price reduction it could obtain from its vendors in a hard negotiation.

In another instance, we issued a report in October 1984 on the costs of industrial security at contractor plants, one of which was the General Dynamics plant in Fort Worth, Texas. This report said that contractors were paying too much for their in-house guard services as compared to the prices charged by commercial firms who were willing to provide the same service on a contracting-out basis. We concluded that DoD could save $9.4 million at the 13 contractors we reviewed. The Department agreed to reinforce its existing policy to contracting officers to make sure they hold contractors to the low cost option.

In a final example, we recently issued a report on progress payments to Defense contractors, for which we reviewed General Dynamics' operations in Fort Worth, Texas and Pomona, California. We showed that current economic conditions no longer justify the high rates of progress payments established in 1981. As a result of this audit, Secretary Weinberger just declared that the rate of progress payments will be immediately reduced, saving the Government $230 million annually in interest costs and a one-time expenditure reduction of $2 billion.

The remaining six published reports are:

1. Government Property in the Possession of Contractors, August 1983.

2. Government-Furnished Material at DoD Production Contractors, February 1984.

3. Initial Spare Parts Procurements for Selected Major Systems, March 1984.

4. DoD-Wide Audit of Procurement of Spare Parts, May 1984.

5. Acquisition of SSN 688 Nuclear Attack Submarines, October 1984.

6. Controls Over Property at Repair and Overhaul Contractor Plants, April 1984.

In addition to the 9 completed projects, there are 13 ongoing audit projects that directly or indirectly involve the General Dynamics Corporation.

For instance, in an ongoing audit of executive compensation, General Dynamics is one of seven Defense contractors we are reviewing. Also, we are auditing the Stinger Missile and the Joint Cruise Missile, both of which are built in part by General Dynamics. Our audit of the Trident Submarine Program is also continuing. In another example, we are auditing General Dynamics' participation in the program to develop and implement value engineering change proposals. (GD is only indirectly involved, however.) Also, we are examining the effectiveness of contract administration in evaluating and controlling overhead at General Dynamics in another ongoing audit.

The remaining areas of ongoing audits involving General Dynamics are:

1. Navy Electronic Warfare and Close In Weapon Systems (GD only indirectly involved).

2. DoD Lab Contract Studies and Analyses (GD only indirectly involved).

3. Negotiated Single Source Procurement (GD only indirectly involved).

4. Engine Test Cells (Hush Houses) (GD only indirectly involved).

5. Contract Pricing (a followup to the DoD-wide Audit of Spare Parts completed in May 1984).

6. Competition in Subcontracting.

7. Should-Cost Techniques (GD only indirectly involved).

INSPECTOR GENERAL RESPONSIBILITIES REGARDING CRIMINAL INVESTIGATIONS

The Inspector General responsibility regarding DoD criminal investigations is threefold: He conducts criminal investigations directly through the Assistant Inspector General for Investigations, who heads the Defense Criminal Investigative Service (DCIS). He provides criminal investigative policy to all criminal investigation organizations, and he oversees all criminal investigations, including those conducted by the Army, Navy and Air Force.

Last year, DoD investigative organizations opened over 16,000 cases, closed over 15,000 cases, referred over 5,000 cases for prosecution or administrative action. These referrals resulted in over 160 indictments, over 500 convictions, and about $25 million in recoveries, fines, penalties, and restitutions.

When the IG was established, Congress decided to leave the military criminal investigative organizations--the Army Criminal Investigation Command, Naval Investigative Service and the Air Force Office of Special Investigations--in their respective Military Departments. Currently in DoD there are 5,968 personnel assigned to the DoD criminal investigation organizations, of which 3,629 are criminal investigators. Of the 3,629 criminal investigators, 161 are assigned directly to the IG, DoD. In addition to the oversight role, the Inspector General Act also permits the IG to request the military criminal investigative organizations to conduct investigations into allegations of particular interest to him. I have made numerous such requests to the Army, Navy and Air Force. It should, however, be pointed out that, in addition to contract fraud, these other investigative organizations have a broad range of other serious crimes to investigate, including narcotics violations, thefts, arson, vandalism, murders, rapes, assaults and other crimes of violence which occur on military bases. Furthermore, the Navy and Air Force criminal investigative agencies have significant responsibilities regarding foreign counterintelligence.

We estimate that there are 750 fraud trained criminal investigators in DoD at present. We have recommended adding 400 more over the next three years.

I believe that my relationship with the military criminal investigative organizations is a productive one. My office, through its oversight role, provides them advice and guidance in investigative techniques, and assists these organizations with regard to training and implementation of new investigative techniques. We also provide leadership and coordination for Department-wide investigative efforts. My office also serves as the primary DoD contact between the Defense criminal investigative organizations and the investigative offices of the Department of Justice, including the Defense Procurement Fraud Unit.

With respect to the role of my office in the development of criminal investigative policy, I should note that virtually no such DoD-wide policy existed when I became Inspector General. In the past two years, we have therefore concentrated our efforts in developing policies such as those in the following new areas:

- Investigative and prosecutive jurisdiction between DoD and DOJ.
- Investigative responsibilities among DoD criminal investigative organizations.
- Issuance of IG subpoenas.
- Use of search warrants.
- Coordination of remedies in fraud cases.
- Access to records.
- Investigative report format.
- Criminal investigative analysis (trend and vulnerability analysis).

In addition, we have conducted a number of oversight projects designed to identify areas where improvements may be required. These include projects dealing with:

- Suspension and Debarment actions.
- Proactive operations by DoD criminal investigative organizations.
- Adequacy of fraud agent strengths.

My office has also placed great significance on enhancing the awareness of DoD investigative personnel to the indicators of fraud. In this regard, we have conducted 15 five-day contract fraud training seminars which have provided advanced contract fraud training to over 500 Defense criminal investigators.

I also believe that it is essential for procurement personnel to be sensitive to fraud schemes by Government contractors. Historically, the majority of contract fraud cases are discovered by contracting officers. Therefore these officials must be aware of contract fraud indicators and to report such information to auditors and investigators. In this regard we have prepared a handbook on contract fraud indicators which has been distributed to 50,000 DoD procurement, audit, and investigative personnel. My office has also conducted over 375 fraud training sessions for 18,000 procurement personnel. This is in addition to 6,400 fraud training sessions which were provided to 240,000 DoD management officials by criminal investigators assigned to the Military Departments.

My office has also issued 14 Fraud Awareness Letters to DoD personnel highlighting specific fraudulent schemes affecting DoD procurement. These Letters are designed to sensitize procurement personnel and to encourage the reporting of possible violations of law. This covers areas such as cost mischarging, shoddy materials, pay and allowance fraud, travel fraud, and medical fraud.

Our commitment to the improvement of fraud awareness has moved outside of DoD. We have developed training materials to be used by trade associations and contractors to assist in identifying to their members and employees the types of procurement fraud which will be investigated and prosecuted by the Government. This is an awareness and prevention effort as it applies to all levels of suppliers, including prime contractors as well as various levels of subcontractors.

Debarments and Suspensions

In addition to these efforts, my office completed a review of Suspension and Debarment Authorities within DoD. Under the Federal Acquisition Regulations, the DoD has the right to protect itself from contractors which cannot adequately demonstrate their responsibility as Government contractors. The regulations relating to suspension and debarment are designed to enable the Government to protect itself from such contractors by barring them from doing business with the Federal Government. My office was concerned that DoD was not taking adequate suspension and debarment action in contract fraud cases because of a lack of coordination between criminal investigators and procurement officials. Our report, which was fully endorsed by Department officials, identified numerous weaknesses in the system. As a result of our report, the Department now has an effective procurement remedy in this area. For example, in 1984, DoD suspended or debarred 454 contractors compared with 79 in 1980.

Inspector General Subpoenas

The Inspector General Act recognized that, in performance of the duties assigned by the Act, Inspectors General would encounter situations where they would need access to various types of documents in the possession of non-Government entities. To meet this need, the Act authorized Inspectors General to require by subpoena the production of any documents or information necessary in the performance of functions assigned by the Act.

Since September 1983, I have issued 110 subpoenas in various matters in the discharge of my responsibilities under the Act. For the most part, the subpoenas were related to inquiries in the areas of procurement, bribery of Government employees, and conflicts of interest. A number of the subpoenas were issued to financial institutions to obtain customer transaction and account data. In such cases, we scrupulously complied with the requirements and procedures of the Right to Financial Privacy Act. To date, we have had only one instance in which we found it necessary to seek enforcement of a subpoena by seeking the order of a United States District Court.

Relations with the Department of Justice

As the Inspector General, I am directly concerned with relations between DoD and the Department of Justice concerning fraud matters which are referred to the DOJ for both criminal and civil action. I believe that DoD and DOJ must address fraud, particularly contract fraud, in a coordinated manner. In that regard my office, and DoD in general, have taken a number of steps to ensure that DoD fraud cases receive full consideration by DOJ for civil and criminal action.

My office stimulated and supported the creation of the Defense Procurement Fraud Unit. This unit, comprised of DoD and DOJ attorneys and investigators, as well as DCAA auditors is designed to act as a centralized coordination and prosecution authority for DoD cases. It allows all DoD cases, nationwide, to be screened for both criminal and civil prosecution potential. I believe that the existence of such a unit is instrumental to a coordinated DOJ/DoD effort and that the unit has the capability of enhancing the likelihood of prosecution of procurement fraud cases.

My office also initiated the renegotiation of a Memorandum of Understanding between DoD and DOJ. The old Memorandum of Understanding, which was 30 years old, did not provide adequate emphasis on procurement fraud or recognize current DoD organizations and problems. The new Memorandum of Understanding permits the early evaluation of cases to determine prosecutive merit and to plan the investigation in such a way as to assure successful prosecution. It enables DoD criminal investigative organizations, along with the FBI, to pursue fraud cases in a professional, cooperative, and hard-hitting manner.

Earlier I mentioned the training which we have provided to DoD personnel. My office has also provided training to DOJ prosecutors and investigators to sensitize them to the needs of DoD, and to orient them to DoD procurement procedures.

Generally, I believe the Government is in a much more capable position to deal with procurement fraud in the DoD than it was two years ago. Working with the DOJ and the FBI, we have increased investigative and prosecutive resources, improved referral procedures, provided enhanced levels of training, developed more significant investigations, and seen an increase in the number of indictments and convictions. For example, in FY

1982, DoD obtained 27 indictments and 102 convictions. In FY 1984, we obtained 174 indictments and 181 convictions.

DoD Hotline

I also operate the DoD Hotline which receives calls and letters from military and civilian personnel who report real or perceived instances of waste, fraud, or mismanagement in Defense programs.

The types of complaints received by the Hotline staff and referred for inquiry or investigation are broad. Callers provide information on fraud, operational mismanagement, theft, irregularities in procurement practices, waste, and abuse of Government property or personnel.

The number of calls and letters received by the Defense Hotline has varied over the past years. During fiscal year 1984 over 7,800 complaints were received, and we have received more than 3,900 complaints during the first six months of fiscal year 1985. This compares with fewer than 1,000 complaints in all of FY 1980. More than one-third of all calls and letters are substantive complaints worth investigating or examining in greater detail.

Contractor Gratuities

The provision of gratuities by contractors to Government employees is a serious problem in Federal procurement. Despite the fact that such gratuities are prohibited by criminal law, and by a clause in every DoD contract, the problem continues. While the purchase of a drink or meal may seem innocent at first examination, I believe that the toleration of such practices leads to an increasing erosion in the integrity of the entire procurement process. We have identified many cases which began as a simple gratuity case and quickly evolved into bribery. In some cases the reason for the gratuity was to induce a contract inspector to look the other way while shoddy materials were provided on DoD contracts.

Recognizing this problem, we have taken a variety of actions to alert DoD employees to the problems ensuing from gratuities.

We have engaged in hundreds of integrity briefings for DoD employees to alert them to the prohibition against gratuities and the need to report any incidents to criminal investigators and contract administrators.

In July 1984, my office initiated a project to review the current policies of major DoD contractors in relation to gratuities. This review is designed to identify such incidents, and assess the criminal, administrative and contractual response by DoD. We are also meeting with the major DoD contractors which are identified in the review to seek more positive statements of corporate policies regarding the provision of gratuities.

My office also recently completed a review of the DoD Standards of Conduct regulation and its implementation by the Military Departments. We have issued a number of recommendations to the DoD General Counsel who is rewriting the DoD regulation.

We also have had substantial success in enlisting the aid of DCAA in identifying incidents of gratuities. Previously, it was DCAA's policy not to make a full inquiry into the circumstances surrounding gratuities when the costs were unclaimed by the contractors. As a result of a review conducted by my office, DCAA is now referring any evidence they uncover relating to suspected gratuities to Government employees to a criminal investigative organization regardless of whether it is charged to the Government.

Investigations of General Dynamics

I know that the Committee has expressed great concern regarding improprieties by General Dynamics regarding Navy shipbuilding contracts. As the Inspector General, I have been very concerned with these improprieties and have been actively involved in oversight of all criminal investigations of General Dynamics.

Currently, the Naval Investigative Service and the Air Force Office of Special Investigations, as well as my own DCIS and the FBI have ongoing investigations relating to General Dynamics. Most of these investigations are being conducted under the auspices of Federal grand juries, which greatly restricts the amount of information which can be disseminated to persons who are not agents of the grand jury. For this reason I cannot comment in greater detail on such investigations.

In addition to these cases, at my request and at the request of the Navy, the Naval Investigative Service is currently conducting an investigation of gratuities which General Dynamics provided to Navy officials. The results of this investigation, relating to the Navy, have been referred for consideration to the Navy Gratuities Board. However, because the Naval Investigative Service investigation identified some non-Navy recipients of gratuities, I have directed my staff to conduct a full investigation of non-Navy DoD officials who received gratuities from General Dynamics.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions which you or any member of the subcommittee may have.

Mr. DINGELL. Mr. Sherick, the committee thanks you for your statement, and we appreciate your courtesy to the committee.

Mr. Sherick, the Chair applauds your actions of yesterday in announcing criminal investigation's of senior DOD officials and military officers for accepting illegal gratuities from General Dynamics.

I am concerned, however, about certain aspects of this. In late January, the subcommittee staff interviewed a number of DOD officials, military officers, including an Assistant Secretary of Defense, with regard to accepting illegal gratuities from General Dynamics.

On February 8, there was press coverage specifically mentioning one Mr. Michael Burch, the Assistant Secretary of Defense for Public Affairs, indicating Mr. Burch allegedly took gratuities from General Dynamics.

On February 21, 1985, an ABC 20/20 segment on General Dynamics abuses also mentioned Mr. Burch.

A week later, the staff of the subcommittee again interviewed DOD Assistant General Counsel Kathleen Buck, the ethics officer in the Office of the Secretary of Defense, who professed no knowledge of Mr. Burch allegedly taking illegal gratuities from General Dynamics.

It wasn't until later that week that investigators from the Defense Criminal Investigative Service, DCIS—or rather it wasn't until last week that investigators from DCIS came to interview the subcommittee staff concerning the General Dynamics gratuities matter. They claimed they had not learned about the issue until the day before in discussions with the subcommittee staff.

I am curious. Why did it take them so long to do this?

Mr. SHERICK. I don't know. They were asleep at the switch, I guess. I didn't watch the 20/20 segment. Certainly if I had watched it, the name would have gotten some action out of me.

Mr. SIKORSKI. It's in the Washington Post. Do you read the Washington Post?

Mr. SHERICK. Sometimes I do, sometimes I'm away.

Mr. DINGELL. Did Kathleen Buck report to you on this matter?

Mr. SHERICK. Not that I know of.

Mr. DINGELL. Was there no request by the Secretary's office for action by your office on this matter?

Mr. SHERICK. No, there was not.

Mr. DINGELL. Did Mr. Weinberger's ethics officer inform the IG in late February about the subcommittee staff's evidence and interviews regarding illegal gratuities taken by top officials at DOD from General Dynamics?

Mr. SHERICK. No.

Mr. DINGELL. I'm curious. Why not?

Mr. SHERICK. You'd have to ask them.

Mr. DINGELL. Well, I am curious. Why would it take the IG 2½ months to discover this kind of information?

Mr. SHERICK. Well, as I indicated to you earlier, the IG has a whole area of responsibility in the Department of Defense, and we normally would have picked something like that up. I'm sorry. I don't know why we didn't. It was an oversight. I'm sure there are many other instances where we don't pick things up. It's just a major organization and, as I build the staff and as I build those kinds of sensitivities, I'm sure that we will pick that kind of thing up.

Mr. DINGELL. Let's address some other investigations here. Procurement fraud is becoming a matter of increasing concern, both to the public and, of course, to this subcommittee in connection with our analysis of corporate ethics under our responsibilities to supervise the SEC and the Securities Exchange and Disclosure Statutes under the jurisdiction of this committee.

Do your criminal investigators actually perform procurement fraud investigations?

Mr. SHERICK. Absolutely. Right now we have a total of 630 investigations underway; 426 or 427 of them are contract fraud investigations and 36 of those investigations involve the top firms in the top 100 list of DOD contractors.

Mr. DINGELL. The subcommittee has had brought to its attention investigations of an Assistant Secretary of Defense who I gather is alleged to have accepted a quantity of Steuben glass with a supposed total of about $600 from an industry trade association.

The Assistant Secretary apparently refused to give up these items, even after confronted by DCIS. Is there an investigation of that matter going on?

Mr. SHERICK. We have the glass, and I don't know that there was any problem with giving it up. We went to him and got it. We had it priced, and told him that he couldn't have it. We are disposing of it according to regulations.

Mr. DINGELL. Didn't he accept that in violation of the law?

Mr. SHERICK. It was an award that some organization gave him, as I understand it. Steuben glass, as you know, something that big may cost $600. It's amazing.

Mr. DINGELL. What is the law on the acceptance of gratuities by Federal employees?

Mr. SHERICK. It wasn't a gratuity. As I say, that's one of the problems that we had to determine. It was an award to an Assistant Secretary of Defense for some logistics activity.

Mr. DINGELL. An award to the Department of Defense?

Mr. SHERICK. That's right.

Mr. DINGELL. It wasn't to him?

Mr. SHERICK. He accepted it as the official.

Mr. DINGELL. And then he kept it?

Mr. SHERICK. He put it in his office; yes.

Mr. DINGELL. Allegations have also been received that he may have arranged for the Government to pay for female friends to accompany him on official trips. The allegation has been made that official records would indicate that it was his executive assistant who was the traveler in question. Is that so?

Mr. SHERICK. He traveled with his executive assistant; yes.

Mr. DINGELL. The allegation was made it was his executive assistant who was traveling with him, but the allegation by the committee is that it was, rather, a female friend who was traveling with him.

Mr. SHERICK. There were female friends with both of them.

Mr. DINGELL. Have you investigated that matter?

Mr. SHERICK. Yes, I have.

Mr. DINGELL. Have you cleared him?

Mr. **Sherick**. He has paid the money.

Mr. **Dingell**. He paid the money?

Mr. **Sherick**. He paid for the tickets involved.

Mr. **Dingell**. He did? Was that before or after you interviewed him?

Mr. **Sherick**. After.

Mr. **Dingell**. He paid for the travel of the female friends after?

Mr. **Sherick**. No, no, no, no.

Mr. **Dingell**. After you interviewed him?

Mr. **Sherick**. Basically, the situation was this: The military executive assistance used points that he earned while on official travel to get tickets which were then used by female friends. These points were accumulated as a Government traveler, and the rule from GAO is that a person may use those points to upgrade their seat and do other things. They cannot use them to get tickets, and the minute they get a ticket it becomes the Government's property. It cannot be used for non-Government purposes, and he was required to pay for the value of those tickets.

Mr. **Dingell**. Would you give us a copy of that report, please?

Mr. **Sherick**. Yes.

Mr. **Dingell**. As a matter of fact, a copy of the report on both of these matters, please.

Mr. **Sherick**. Oh, certainly. With respect to the Steuben glass issue, I don't know if we have the final report. I don't have any problem giving it to you as soon as we finish.

Mr. **Dingell**. Thank you.

[Testimony resumes on p. 463.]

[The following information was submitted:]

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

12 AUG 1985

RECEIVED
AUG 12 1985
Subcommittee on Oversight
and Investigations

Honorable John D. Dingell
Chairman
Subcommittee on Oversight and
  Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Mr. Hodges, of your staff, has called my staff regarding publishing two Inspector General investigative reports in the record of the April 24, 1985 hearing of your Subcommittee. As I stated in my June 14, 1985 letter to you transmitting these reports, they are "For Official Use Only" and should not be released outside the Committee.

I continue to believe that the complete text of these reports should not be released outside the Committee. However, I am enclosing redacted versions of both of these reports in which the identities of innocent parties and those who were not the subject of the investigation have been deleted.

A copy of this letter and the enclosures are being provided to Representative Broyhill, the Ranking Minority Member of the Committee.

Sincerely,

Joe Sherick
Joseph H. Sherick
Inspector General

Enclosures

DEPARTMENT OF DEFENSE
OFFICE OF THE INSPECTOR GENERAL
SPECIAL INQUIRIES

REPORT OF INVESTIGATION

CASE NUMBER

84-T01716

DATE

November 30, 1984

ALLEGED MISUSE OF TRAVEL FUNDS
BY ASD(MI&L)

REPORTING INVESTIGATOR

SPECIAL INVESTIGATOR [redacted]

INFORMATION CONTAINED IN THIS DOCUMENT WILL NOT BE DISCLOSED TO ANYONE OTHER THAN THE ADDRESSEE NOR REPRODUCED IN WHOLE OR IN PART WITHOUT THE APPROVAL OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

84-T01716 **CASE SUMMARY** November 30, 1984

Investigation was initiated upon receipt of a Hotline complaint alleging the Assistant Secretary of Defense for Manpower, Installations and Logistics (MI&L), used a Government Travel Request (GTR) to transport his girlfriend to San Francisco, California, during the Labor Day weekend [redacted]. The inquiry disclosed that the Assistant Secretary and his military assistant were joined in San Francisco by two female friends from the Washington, DC area. The inquiry refuted that a GTR was procured but did disclose that the two women performed their travel as a result of "free" tickets obtained by the military assistant utilizing "mileage plus" benefits acquired while on official TDY--a violation of a ruling by the Comptroller General of the United States which states that tickets so acquired are the property of the United States and useable only for official travel. The investigation also determined that although the Assistant Secretary did not know of the "mileage plus benefits" nature of the tickets, he did, in fact, designate the beneficiary of valuable transportation services offered by a subordinate and, therefore, accepted a gratuity from a subordinate in violation of Department of Defense Directive 5500.7. [redacted]

It is recommended that appropriate action be taken regarding the Assistant Secretary receiving a gratuity from a subordinate; that the Assistant Secretary be cautioned regarding the appearance of his inter-mingling public business and private activities; that appropriate actions be taken against the military assistant to include reimbursing the Government for the constructive cost of the tickets and for violation of Department of Defense Directive 5500.7 and the Comptroller General's ruling.

84-T01716

November 30, 1984

I. INTRODUCTION:

This investigation was initiated upon the September 28, 1984 direction of the Inspector General, Department of Defense, subsequent to an anonymous Hotline allegation wherein the complainant alleged that Dr. Lawrence J. Korb, Assistant Secretary of Defense for Manpower, Installations and Logistics, traveled to San Francisco, California on August 31, 1984, accompanied by his girlfriend, [redacted] The complainant further alleged that [redacted] traveled by Government Travel Request (GTR), under the name of D. BATES--the name of Dr. Korb's military assistant [redacted]

II. FINDINGS:

A. Interview of Colonel Bates

1. On September 17 and 18, 1984, subsequent to appropriate advisement of his rights in accordance with Article 31b, Uniform Code of Military Justice, Colonel Daniel G. Bates, USAF, furnished sworn testimony regarding his trip to San Francisco during the Labor Day weekend.

2. Colonel Bates advised that from August 31 through September 7, 1984, he accompanied Dr. Korb on a West Coast trip that included Salt Lake City, San Francisco and Vandenberg Air Force Base. Dr. Korb spoke at the American Legion Convention in Salt Lake City, met with city officials in the San Francisco-East Bay Area regarding housing for military members, and inspected the space launch pad construction site and initiated the United Way Campaign at Vandenberg Air Force Base. Dr. Korb's travel engagements were confirmed by his official itinerary schedule.

3. Colonel Bates readily admitted that his girlfriend, [redacted] and a female friend of Dr. Korb, [redacted] joined them in San Francisco during the Labor Day weekend. Colonel Bates stated he acquired the tickets for [redacted] [redacted] [redacted] neither of whom are Government employees, through his Pan American mileage plus program. Colonel Bates stated that the women arrived in San Francisco on Friday afternoon, September 1, 1984. Colonel Bates advised that both women stayed with [redacted] relatives in [redacted] and used an automobile belonging to one of the relatives for transportation. Colonel Bates stated he and Dr. Korb were billeted at the Fort Mason Officers' Club during their stay in San Francisco. [redacted]

[redacted] Colonel Bates advised [redacted] departed San Francisco on Monday, September 3, 1984, and that he and Dr. Korb left for Vandenberg Air Force Base on Wednesday, September 5, 1984.

4. Colonel Bates readily acknowledged that he knew the use of mileage plus to obtain tickets was in violation of the Comptroller General's ruling and that he "erred in judgement" in doing so and, in retrospect, realizes it was wrong. Colonel Bates stated that this is the only time he has ever had his girlfriend join him during a Government trip. He acknowledged that it was his idea to have someone accompany [redacted] to San Francisco and asked Dr. Korb whom he would prefer. Dr. Korb selected [redacted] Colonel Bates went on to say that he travels with Dr. Korb 80% of the time, that neither have been accompanied or joined on previous trips by female companions and that he has not used either his Pan American or United mileage plus programs for free tickets before.

5. Colonel Bates concluded by reiterating that having [redacted] [redacted] [redacted] use his "free" tickets was totally his idea so that [redacted] could have company on the trip, that Dr. Korb did not request him to do it, and that Dr. Korb only stated his preference as to whom he would like to accompany [redacted]

6. Colonel Bates subsequently furnished a recent statement he had received from Pan American which reflected his trading of mileage for "free" tickets.

B. Interview of Dr. Korb

1. On September 19, 1984, Dr. Korb reiterated much of what Colonel Bates had stated, expanding on the reasons for his West Coast trip and the events leading to his meeting [redacted] in San Francisco. Dr. Korb stated Colonel Bates told him his girlfriend, [redacted] was going to meet him in San Francisco and that he had an extra ticket if he (Dr. Korb) wanted to have someone use it. Dr. Korb asked Colonel Bates to give it to [redacted] Dr. Korb denied knowing where the ticket came from and stated he did not ask Colonel Bates. [redacted]

2. At the time of the interview, Dr. Korb was aware of how Colonel Bates had obtained the tickets. Dr. Korb stated he was also aware of the Comptroller General's ruling on Government employee's use of mileage plus, as well as the Deputy Secretary of

Defense implementation of the ruling. (It is noted that Dr. Korb is the senior official in the Department of Defense responsible for travel.) Dr. Korb furnished a copy of his Pan American mileage plus receipts which reflect he has used his mileage plus for upgrading to first class and to join the Pan American Clipper Club. Dr. Korb stated he also belongs to the United Airlines mileage club but did not have a copy of his mileage plus status. Dr. Korb averred he had never used his mileage plus account to obtain "free" tickets as he knew it was illegal.

C. Review of Travel Records

1. On September 17 and 18, 1984, [redacted] Travel Division, Washington Headquarters Services, Pentagon, advised Dr. Korb's travel voucher had not yet been submitted but furnished the travel voucher submitted by Colonel Bates. Except for coding errors and a statement in lieu of a rental car receipt, everything appeared to be in order. (Note: Colonel Bates subsequently found the rental car receipt which reflected he had shorted himself $2.00 on the voucher.) The voucher reflected Colonel Bates paid $21.00 a day for his Government quarters at the Fort Mason Officers' Club in San Francisco. Submitted with the voucher were portions of unused tickets. The records reflect Colonel Bates was issued two tickets--one to depart Washington, DC on August 31 to Salt Lake City and San Francisco and return on September 5, and the other to depart from Washington, DC on September 6 to Los Angeles and return on September 7. Colonel Bates used the Salt Lake City and San Francisco portion of the first ticket and the Los Angeles to Washington, DC portion of the second ticket, having traveled from San Francisco to Los Angeles by Government air. It was subsequently ascertained that two tickets were issued as it was uncertain if Dr. Korb would have to return to Washington, DC on September 5 to testify at a hearing and then fly to Vandenberg Air Force Base.

2. [redacted] checked [redacted] files which indicated no person by the name of [redacted] was listed in the travel office records. [redacted] stated [redacted] [redacted] certain the GTRs requested by Dr. Korb's office were used by the named individuals as she processes all the travel vouchers from his office and would note any suspicious claims. [redacted] noted that Dr. Korb travels a lot.

[redacted]

[redacted]

E. Department of Defense Directive 5500.7

Department of Defense Directive 5500.7 "Standards of Conduct" specifically prohibits any Government employee (civilian or military) from receiving gratuities. In a superior/subordinate relationship the Directive states "DoD personnel shall not make a donation or gift to an official superior or accept a gift from other DoD personnel subordinate to themselves."

III. CONCLUSIONS:

A. Government travel requests were not obtained for any unauthorized individual.

B. The trip to the West Coast was in connection with Dr. Korb's official duties.

C. [redacted] joined Dr. Korb and Colonel Bates in San Francisco for the Labor Day weekend.

D. Colonel Bates procured round-trip tickets to San Francisco for [redacted] by using his Pan American mileage plus benefits, thus violating the Comptroller General's ruling and Department of Defense policy.

E. Dr. Korb and Colonel Bates were fully aware that mileage plus obtained through Government travel could not be used in this manner and that mileage plus tickets belonged to the Government.

F. Dr. Korb states that he did not know the tickets were Government property derived from mileage plus program credits acquired on official TDY, but he did acknowledge being the beneficiary of the mileage plus ticket when he designated that it be given to [redacted]--tantamount to his directly receiving a gratuity from a subordinate.

G. No additional cost to the Government was incurred by Dr. Korb or Colonel Bates as a result of [redacted] [redacted] presence in San Francisco; however, the value of the tickets was lost to the Government.

IV. RECOMMENDATIONS:

A. The Secretary or Deputy Secretary of Defense counsel Dr. Korb regarding the visibility of his position and his public image, advising him to be more sensitive to the appearance he creates in travel situations in which he intermingles public business and private activities. Counseling should also address the seriousness of the violation of DoD Directive 5500.7, Standards of Conduct, and its prohibition against acceptance of a gift from subordinates. The fact that the gift was, in fact, the property of the United States Government converted to personal use should be highlighted.

B. Appropriate action be taken against Dr. Korb for receiving a gratuity from a subordinate as required by DoD Directive 5500.7.

C. Appropriate action be taken against Colonel Bates for knowingly violating the Comptroller General's ruling and DoD Directive 5500.7, to include reimbursing the Government the constructive cost of the round-trip tickets.

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
OFFICE OF ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS
DEFENSE CRIMINAL INVESTIGATIVE SERVICE
WASHINGTON FIELD OFFICE
900 S. WASHINGTON ST., SUITE 200, FALLS CHURCH, VA 22046

DCIS REPORT OF INVESTIGATION

Title/Subject: KORB, Lawrence J. Date : May 3, 1985

SSAN : 100-30-4711 Status: Closed
D/POB : July 9, 1939 - New York, NY
POSITION : Assistant Secretary of Defense
(Manpower, Installations and Logistics)

Control : N8501015E

Reporting
Agent : [redacted]
Defense Criminal Investigative Service
[redacted]

Made At : [redacted]

SYNOPSIS

1. Investigation established that Subject accepted a Steuben glass eagle valued at $595.00 from the American Logistics Association (ALA) for the performance of his Department of Defense (DoD) duties in the management of the military commissary and exchange systems. The United States Attorney's Office declined prosecution citing no criminal violation. The glass eagle has been returned to Subject who has been advised to consult with the Office of General Counsel regarding its disposition.

BACKGROUND/PREDICATION

2. [redacted] requested an investigation into the propriety of Subject receiving a Steuben glass eagle reportedly valued at $10,000 for his participation in the annual convention of the ALA. Subject reportedly participated in the convention in connection with his official DoD duties as the Assistant Secretary of Defense (Manpower, Installations and Logistics) (ASD(MI&L)), and therefore, may be in violation of 18 USC 209 (Supplementation of Income) for accepting the glass eagle.

INVESTIGATIVE DETAILS

3. Subject was interviewed on March 20, 1985, and stated he participated in the annual convention of the ALA, held in October, 1984, at the Hyatt Regency Hotel, Crystal City, VA. Subject stated he made a presentation at the convention involving the accomplishments of his four years as the ASD(MI&L). Subject identified a Steuben glass eagle located in his office as having been presented to him at the ALA convention for his leadership in Armed Forces management. The base bears the inscription "The American Logistics Association Honors Dr. Lawrence J. Korb for Leadership in Armed Forces Management October, 1984." Subject voluntarily released the Steuben glass eagle and base to reporting agent.

4. Photographs and a description were sent to Steuben Glass, Corning, NY, to obtain an appraisal of the Steuben glass eagle. On April 4, 1985, the appraisal was received and reflects the value of the eagle to be $595.00

5. [redacted] was interviewed and stated the Steuben glass eagle was presented to Subject at the 1984 annual convention of the ALA as an award for Subject's management of the military commissary and exchange systems as the ASD(MI&L). [redacted] provided documentation which reflects the cost of the glass eagle and base to be $627.33.

STATUTES/VIOLATIONS

6. Subject's acceptance of the Steuben glass may also be in violation of DoD Directive 5500.7 (Standards of Conduct) which prohibits Government employees from using public office for private gain and from accepting gifts or anything of value from those who have or seek business with the Department of Defense and from those whose business interests are affected by DoD functions. Assistant United States Attorney (AUSA) Joseph Aronica, Chief of Criminal Division, Eastern District of Virginia, opined that Subject was not in violation of 18 USC 209.

STATUS OF PROSECUTION

7. AUSA Aronica was briefed regarding the results of this investigation on April 8, 1985, and declined prosecution. AUSA Aronica said he did not consider Subject's acceptance of the eagle a criminal matter, but rather a standards of conduct issue that should be handled by an ethics counselor.

STATUS OF INVESTIGATION

8. All logical leads have been completed and, in the absence of a criminal violation, this case is closed.

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-4000

MANPOWER,
INSTALLATIONS
AND LOGISTICS

10 May 1985

MEMORANDUM FOR THE INSPECTOR GENERAL DOD

SUBJECT: Addendum to Report of Investigation, Case Number 84-T01716, Alleged Misuse of Travel Funds by ASD(MI&L), November 30, 1984

I have carefully reviewed the report and feel that the investigator drew three erroneous conclusions from my oral testimony.

-- The ASD(MI&L) did not receive any direct or indirect benefit from the use of my bonus tickets. As indicated on page 1, paragraph II, A,5 of the Findings. The purpose of having an additional person on the trip was to provide a companion for my friend.

-- The ASD(MI&L) did not designate nor invite an additional person to make the trip. He suggested several people for my girlfriend to review who might be a suitable travelling companion. We (my friend and I) jointly chose and I invited one individual.

-- At no time did I intend to provide a gratituty to my superior in violation of Defense Directive 5500.7. I wanted to ensure that my friend came to San Francisco. Having someone accompany her was the way to accomplish that purpose.

I request that this statement be appended to the report and that it only be forwarded along with the report to any individual or agency that receives a copy of this report in accordance with the Freedom of Information Act.

I am making this statement now because it has come to my attention that Congress will be furnished a copy of this report and I want to set the record straight.

Daniel G. Bates
COL, USAF
Mil Asst ASD(MI&L)

BEST COPY AVAILABLE

DEPARTMENT OF DEFENSE
OFFICE OF GENERAL COUNSEL
WASHINGTON, D.C. 20301-1600

May 21, 1985

MEMORANDUM FOR OFFICE OF INSPECTOR GENERAL

SUBJECT: DCIS Report of Investigation - Lawrence J. Korb

This is in response to your informal request for a legal analysis of the subject report of investigation.

Without repeating all of the facts outlined in the report, the key ones will be summarized: Dr. Korb made a presentation at the annual convention of the American Logistics Association (ALA) and afterwards was given a gift valued at approximately $600.00. The inscription, "The American Logistics Association Honors Dr. Lawrence J. Korb for Leadership in Armed Forces Management October, 1984," appears on the base of the gift, a Steuben glass eagle.

The investigator discussed these facts with an Assistant United States Attorney who opined that Dr. Korb had not violated 18 U.S.C. § 209, the law that prohibits Government officials and employees from accepting compensation from nongovernment sources for their Government work. The law is summarized in an enclosure to the Standards of Conduct Directive (DoDD 5500.7, encl. 2, page 2). The summary says that the law "prevents executive branch personnel from receiving, and anyone from paying them, any salary or supplementation of salary from a private source as compensation for their Government service."

The facts set out in the report do not describe a violation of the Directive's "gratuities rule." Although the American Logistics Association is made up of a number of contractors, that is, "those who have or seek business with the Department of Defense," it has been the interpretation of the Department to permit gratuities given in the name of such an association. For example, DoD personnel may accept free tickets to seminars where the cost is borne by the association rather than by an individual or corporate member. In this instance, however, it appears that the gift was intended to be direct reward for the performance of Dr. Korb's official duties.

We would not object if the presentation were part of a recognized and established award program of the Association. The

Department of Justice has permitted cash awards under certain circumstances:

> We have consistently construed 18 U.S.C. § 209(a) and its predecessors to forbid only those payments which are intended to serve as additional compensation to the individual for undertaking or performing government service. [Citations omitted.] This interpretation is based upon the intent of Congress to preclude the development of conflicting loyalties on the part of employees by preventing them from becoming dependent in part on outside compensation for performing their public duties. (April 7, 1977 opinion of Leon Ulman, Deputy Assistant Attorney General, Office of Legal Counsel.)

Typical of the awards found acceptable by the Department of Justice are the Rockefeller Public Service Awards. In the instant case, however, the circumstances would reasonably be construed to indicate payment for the speech rather than an award for public service.

I recommend that Dr. Korb be advised that receipt of the gift appears to be inconsistent with the Standards of Conduct Directive. He should be encouraged to seek advice from legal counsel or the Designated Agency Ethics Official before he accepts any gifts in the future. However, because the reported facts do not suggest deliberate violation I see no objection to his retention of the glass eagle.

David W. Ream
Office, Assistant General Counsel
Office of Legal Counsel

cc:AGC(PM)

DEPARTMENT OF DEFENSE
OFFICE OF THE INSPECTOR GENERAL
WASHINGTON, D.C. 20301

3 JUN 1985

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (MANPOWER, INSTALLATIONS AND LOGISTICS)

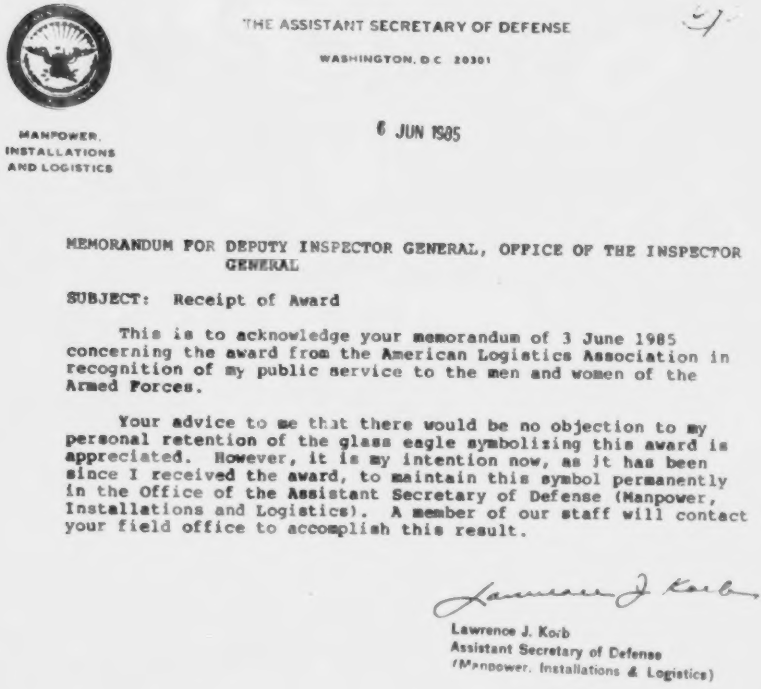
SUBJECT: Inquiry Concerning Receipt of Award

We have completed our inquiry concerning the Steuben glass eagle you received from the American Logistics Association. Our inquiry determined that the eagle is valued at $595 and was presented to you as an award for performance of your official duties as Assistant Secretary of Defense (Manpower, Installations and Logistics).

The Office of the General Counsel determined that receipt of the gift appears to be inconsistent with the Standards of Conduct directive, DoDD 5500.7, and suggested you seek advice from legal counsel or the Designated Agency Ethics Official before accepting any gifts in the future. However, since the facts in our investigation did not suggest deliberate violation, the Office of General Counsel has no objection to you retaining the glass eagle.

Please contact the Washington Field Office, Defense Criminal Investigative Service at 746-0256 to arrange for return of the eagle. We intend no further action in this matter.

Derek J. Vander Schaaf
Deputy Inspector General



THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

MANPOWER,
INSTALLATIONS
AND LOGISTICS

6 JUN 1985

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Receipt of Award

This is to acknowledge your memorandum of 3 June 1985 concerning the award from the American Logistics Association in recognition of my public service to the men and women of the Armed Forces.

Your advice to me that there would be no objection to my personal retention of the glass eagle symbolizing this award is appreciated. However, it is my intention now, as it has been since I received the award, to maintain this symbol permanently in the Office of the Assistant Secretary of Defense (Manpower, Installations and Logistics). A member of our staff will contact your field office to accomplish this result.

Lawrence J. Korb

Lawrence J. Korb
Assistant Secretary of Defense
(Manpower, Installations & Logistics)

Mr. SIKORSKI. Did you answer clearly when he returned the money?

Mr. SHERICK. He returned the money after I concluded the investigation. It originated as a hotline complaint.

Mr. DINGELL. Oh, after you started the investigation he returned the money?

Mr. SHERICK. Absolutely.

Mr. DINGELL. Not before?

Mr. SIKORSKI. And have you taken this any further?

Mr. SHERICK. I reported it to the Secretary of Defense.

Mr. DINGELL. What action did the Secretary take?

Mr. SHERICK. I don't know.

Mr. DINGELL. Thank you.

The Chair is going to recognize the gentleman from Oregon.

Mr. WYDEN. Thank you, Mr. Chairman.

Mr. Sherick, you know, we get a lot of newspaper clippings and a lot of materials come our way, and I saw a story in the Washington Post on September 27, 1984, where you were quoted as saying, and I quote here: "Many of the congressional investigations that expose waste in military purchases merely recycle facts that my investigators uncovered."

Again quoting here, you said: "Most of these people are living off of our audits."

Mr. SHERICK. That's right. I said that, and I believe it.

Mr. **Wyden**. Let's explore that then, Mr. Sherick. Did your investigators know about Fursten and the chili cookoff—let me just finish now—the barbecue that was flown in from Texas, the $500 box spring and mattress, the $18,000 Christmas party, the use of corporate aircraft for fun and recreation, and the charging of airline tickets to attend birthday parties? This is all what went on in the General Dynamics case.

Now, did your people know about this?

Mr. **Sherick**. No. My people did not audit that.

Mr. **Wyden**. Why not?

Mr. **Sherick**. Because it is the Defense Contract Audit agency's responsibility to audit contracts. I was clearly delineated from auditing the day-to-day contract activities. There are 3,400 auditors in the Defense Contract Audit Agency, and that is what they get paid to do. That is what they are trained to do, and that's what they do.

I have less than 100 auditors who handle major procurement programs. We do not conduct contract audits unless it is in connection with a major weapons system audit that we are doing.

Mr. **Wyden**. But this is suspected fraud and it involves the Nation's largest defense contractor, and I will tell you, that example alone makes it pretty clear that we are not living off the audits. It seems to me it is real clear what is going on here. Either you didn't know about it and that was a problem in the system because it's suspected fraud, or you did know about it and nothing was done.

Either way, the taxpayers didn't get the kind of protection they needed.

Mr. **Sherick**. Absolutely. As I told you earlier, one of the responsibilities of the Defense Contract Audit Agency is to report suspected fraud to me. If they report it to me, I investigate it. There are no "ands, ifs, or buts."

Mr. **Dingell**. Have these matters been reported to you?

Mr. **Sherick**. I don't know.

Mr. **Dingell**. Are you now investigating them?

Mr. **Sherick**. We are. As I told you, we have investigations underway on General Dynamics. In fact, we have proactive work on it.

Mr. **Dingell**. We are forwarding copies of the transcript of these proceedings to the Department of Defense. Are they being referred to your office for action?

Mr. **Sherick**. I have seen two of them, the one involving Lewis and another one.

Mr. **Dingell**. Mr. Lewis has been before this subcommittee on two occasions.

Mr. **Sherick**. Right. Well, I saw the one.

Mr. **Dingell**. Not the other?

Mr. **Sherick**. I don't remember seeing the other. I think the other would come in to my criminal investigators. They would first of all find out if it is being investigated by the FBI or some investigative organization in the Department. If not, we would either assign someone to investigate it or we would investigate it.

Mr. **Wyden**. My own view, Mr. Sherick, is you are living off of our hearings.

Mr. **Sherick**. I will take anything I can get, believe me.

Mr. **Wyden**. I just wanted to get a chance to correct that article in the Washington Post.

Mr. **Sherick**. Well, with respect to that article in the Washington Post, I found both of those things. In the spare parts area, they were my audits. I ran the largest audit ever run in the Department of Defense, involving 400 auditors, and I think that we did a good job. We found those things, and we took an awful lot of punishment from everybody for doing that: from within the Department of Defense, from the contractors, and from everyone else.

Mr. **Dingell**. What ultimately became of those audits?

Mr. **Sherick**. First of all, we looked at 202 contractors. We found that 95 of them had overpriced parts to the Department of Defense.

Mr. **Dingell**. Have you made recommendations on these matters?

Mr. **Sherick**. We have underway audits of the 95 contractors, and we are auditing almost everything they sold us. The initial audit was on a sample where we looked at as few as three or four items per contractor. In this audit we are looking at almost everything those contractors sold us. We are looking for defective pricing, and we are turning over defective pricing problems to our criminal investigators. We are going for refunds in those instances where we can't prove defective pricing but where their pricing is out of line.

Mr. **Dingell**. Have you made recommendations for changes in the rules and regulations relative to audits and relative to payment for circumstances of this kind?

Mr. **Sherick**. Yes, we have. Our audit report contained a number of recommendations.

Mr. **Dingell**. Would you submit those to us, please?

Mr. **Sherick**. I would be glad to.

[Testimony resumes on p. 476.]

[The requested information follows:]

DEFENSE-WIDE AUDIT OF PROCUREMENT OF SPARE PARTS

ARMY AUDIT AGENCY RECOMMENDATIONS

(1) The Assistant Secretary of the Army (Research, Development and Acquisition) issue Army guidance specifying that allowable profit for risk on unpriced contracts should be commensurate with the risks accepted by contractors. In formulating the guidance, consider (i) using the profit for risk allowable on cost reimbursable contracts; (ii) setting up a sliding scale of profit for risk that depends on the speed with which prices in unpriced contracts are definitized; and (iii) requesting that the Federal Acquisition Regulation and its Defense Supplement be modified to be more specific. (Recommendation A-1)

(2) The Commander, U.S. Army Materiel Development and Readiness Command direct subordinate activities to stop using unpriced contracts for acquisitions costing less than $25,000. (Recommendation A-2)

(3) The Commander, U.S. Army Materiel Development and Readiness Command require subordinate commands to use cost and price analysis, contract audit, and DD Forms 633 on all unpriced contracts valued at less than $500,000. As an option, combine smaller unpriced orders with the same contractor until the $500,000 threshold is exceeded and the use of these internal controls is required by existing regulations and directives. (Recommendation A-3)

(4) The Commander, U.S. Army Materiel Development and Readiness Command prepare and publish specific breakout criteria and procedures for provisioning spare parts, and mandate their use by all subordinate commands. (Recommendation B-1)

(5) The Commander, U.S. Army Materiel Development and Readiness Command construct and implement a cost model that will (i) estimate the potential costs and price reductions attributable to breakout or increased competition, (ii) compare the two figures, and (iii) identify whether breakout or competition is cost effective. (Recommendation B-2)

(6) The Commander, U.S. Army Materiel Development and Readiness Command jointly develop and publish a standard, easily understood definition of the intrinsic value concept. If necessary, coordinate the definition with DoD. (Recommendation C-1)

(7) The Commander, U.S. Army Materiel Development and Readiness Command prepare and publish standard, mandatory procedures for implementation of the intrinsic value concept. (Recommendation C-2)

(8) The Commander, U.S. Army Materiel Development and Readiness Command as part of the standard procedures, combine the intrinsic value and independent government estimate concepts into a single internal control. (Recommendation C-3)

(9) The Commander, U.S. Army Materiel Development and Readiness Command design and implement a computer model which will incorporate all the measurements that can be used to identify the potential for overpricing. Have the model consider and analyze all available information, measure the risk of overpricing inherent in each acquisition, and identify and report on the potential for overpricing and its causes. (Recommendation E-1)

(10) The Commander, U.S. Army Materiel Development and Readiness Command stop using the 25-percent factor as a parameter for identifying unacceptable price escalation in a year. Replace the 25-percent parameter with one more in line with inflation rates published in the Consumer Price Index or some other appropriate government publication. (Recommendation E-2)

(11) The Commander, U.S. Army Materiel Development and Readiness Command reevaluate future years' requests for additional acquisition and contracting personnel and fund requirements for automation enhancements using economic analysis and comparisons of in-house costs with contractors' costs. Identify and analyze all alternatives, measure the costs and benefits from each, and select and implement the least costly acceptable one. (Recommendation F-1)

(12) The Commander, U.S. Army Materiel Development and Readiness Command pursue recoupment of overpricing found in our sample of spare parts to the maximum extent possible. Include these actions in the recoupment program:

- Legal recovery of overpicing where defective pricing exists.

- Voluntary recovery of excess profits on other overpriced parts. (Recommendation G-1)

(13) The Commander, U.S. Army Materiel Development and Readiness Command study the advantages and disadvantages of (i) using a contract clause requiring all spare parts contractors to pass savings on the costs of subcontracted spare parts on to the Army and (ii) including incentive provisions in such a clause. Prepare and use such a clause if it is found worthwhile. (Recommendation G-2)

NAVAL AUDIT SERVICE RECOMMENDATIONS

(14) Aviation Supply Office (ASO), Philadelphia, PA request Administrative Contracting Officers to provide lists of ASO-managed items that contractors purchase complete from subcontractors and screen these items to the extent necessary for purchase breakout to the subcontractor. (Recommendation 1, Northeast Region)

(15) ASO establish procedures to periodically request lists of purchase-complete items and maintain records of breakout reviews of these item. (Recommendation 2, Northeast Region)

(16) ASO determine the amount of unjustified payment for item 2R1560-00-146-2214 under contract N00383-81-G-1501, order 1640, and seek a refund from the prime contractor in accordance with point seven of the Secretary of Defense 10-point program to improve spare parts procurement practices. Implementation of this recommendation will result in a net potential one-time collection of $73,000 in addition to the $5,800 also identified in this finding. (Recommendation 3, Northeast Region)

(17) Ships Parts Control Center (SPCC), Mechanicsburg, PA request Administrative Contracting Offices to provide lists of SPCC-managed items that contractors purchase complete from subcontractors, and screen these items to the extent necessary for purchase breakout to the subcontractor. (Recommendation 4, Northeast Region)

(18) SPCC establish procedures to periodically request lists of purchase complete items and maintain records of breakout reviews of these items. (Recommendation 5, Northeast Region)

(19) SPCC instruct personnel responsible for technical reviews of item purchases in the need for effective examination of drawings or other data in limited-screening purchase breakout efforts. (Recommendation 6, Northeast Region)

(20) Commanding Officer, Naval Plant Representative Office (NAVPRO), St. Louis establish procedures that compare reasonable costs with prices charged by contractors and request refunds where these prices are determined unreasonable. (Recommendation 1, Capital Region)

(21) Commander, Naval Air Systems Command (NAVAIR) require NAVPRO St. Louis to provide lists of spare parts purchased complete from various tiers of subcontractors for possible purchase breakout to the Original Equipment Manufacturer (OEM). (Recommendation 2, Capital Region)

(22) NAVAIR require spare parts with National Stock Numbers be screened through the Federal Supply System and procured at the lowest available price, in accordance with DoD Directive 4140.40. (Recommendation 3, Capital Region)

(23) NAVAIR require costs to be properly allocated to spare parts, as required by Cost Accounting Standard 418. (Recommendation 4, Capital Region)

(24) NAVPRO Bethpage establish procedures that compare reasonable costs with prices charged by contractors and request refunds where these prices are determined unreasonable. (Recommendation 5, Capital Region)

(25) NAVAIR require NAVPRO Bethpage provide lists of spare parts purchased complete from all tiers of subcontractors for possible purchase breakout to the OEM. (Recommendation 6, Capital Region)

(26) NAVAIR require spare parts with National Stock Numbers be screened through the Federal Supply System and procured at the lowest available price, in accordance with DoD Directive 4140.40. (Recommendation 7, Capital Region)

(27) NAVPRO Bethpage perform more frequent intrinsic value analyses of spare parts to ensure fair prices are paid. (Recommendation 8, Capital Region)

(28) Superintendent of Shipbuilding, Conversion and Repair (SUPSHIP), Bath establish procedures that compare reasonable costs with prices charged by contractors and request refunds where these prices are determined unreasonable. (Recommendation 9, Capital Region)

(29) Commander, Naval Sea Systems Command (NAVSEA) require SUPSHIP Bath to provide a list of spare parts purchased complete from all tiers of subcontractors and for possible purchase breakout to the OEM. (Recommendation 10, Capital Region)

(30) NAVSEA evaluate contract and subcontract agreements which prevent breakout of spare parts to the OEM and modify or eliminate these agreements accordingly. (Recommendation 11, Capital Region)

(31) NAVPRO Bethpage request Defense Contract Audit Agency (DCAA) assist audits of major or critical subcontractors before negotiating future spare parts contracts. (Recommendation 12, Capital Region)

(32) NAVPROs St. Louis and Bethpage ensure DCAA includes the extent of audit coverage and the nature and extent of sampling techniques employed in their audit reports of spare parts proposals. (Recommendation 13, Capital Region)

(33) NAVPRO St. Louis request DCAA audit assistance in investigating the possibility of reducing the Government's costs to reflect reduced subcontractor costs. (Recommendation 14, Capital Region)

(34) NAVAIR include adjustment clauses in future contracts or contract modifications and require prime contract prices to be recalculated if the prime contractor "redetermines" subcontractor costs, as provided in DAR 3-807.9(d). (Recommendation 15, Capital Region)

(35) NAVAIR establish criteria for pricing future fixed-rice incentive subcontracts at ceiling under a prime contract. (Recommendation 16, Capital Region)

(36) NAVPRO St. Louis request DCAA assist audits of major subcontractors before negotiating future spare parts contracts, as provided for in DAR 3-807.9. (Recommendation 17, Capital Region)

(37) NAVAIR require NAVPRO St. Louis negotiate prices on contracts within the time limits set in DAR 4-309. (Recommendation 18, Capital Region)

(38) NAVPRO St. Louis require the contractor to segregate cancelled spare parts items to ensure more timely negotiations. (Recommendation 19, Capital Region)

(39) NAVPRO St. Louis perform thorough Contractor Procurement System Reviews (CPSRs), as required by DAR 23-103. (Recommendation 20, Capital Region)

(40) NAVAIR assign a team of specialists to perform CPSR reviews every three years, as provided for in DAR Supplement 1. (Recommendation 21, Capital Region)

(41) NAVPRO St. Louis correct deficiencies already identified by DCAA and discussed in this report. (Recommendation 22, Capital Region)

(42) Commanding General, Marine Corps Logistics Base (MCLB), Albany review available technical reprocurement data in technical data repository for all procurements which require technical support. (Recommendation 1, Southeast Region)

(43) MCLB Albany revise procurement method codes (PMC) codes on line items identified as being available from other than the original prime contractor and load other sources of supply into the Technical Data Management File. (Recommendation 2, Southeast Region)

(44) MCLB Albany establish a master inventory list in the technical data repository for all technical data. (Recommendation 3, Southeast Region)

(45) MCLB Albany develop procedures to review cost and pricing data in contract files for other possible vendor sources of supply for spare parts. (Recommendation 4, Southeast Region)

(46) MCLB Albany implement the spare parts breakout program, as required by Marine Corps Order (MCO) 4200.22C. (Recommendation 5, Southeast Region)

(47) MCLB Albany request reimbursement for prices paid in excess of catalog prices for spare parts. Implementation of this recommendation will result in a net potential one time savings of $18,594. (Recommendation 6, Southeast Region)

(48) MCLB Albany ensure that contracts are awarded competitively to the maximum extent practical, as required in DAR, par. 3-202.2. (Recommendation 7, Southeast Region)

(49) MCLB Albany ensure that first article testing in contracts is consistently applied. (Recommendation 8, Southeast Region)

AIR FORCE AUDIT AGENCY RECOMMENDATIONS

(50) Headquarters, Air Force Logistics Command (HQ AFLC) should:

a. Assess the cost effectiveness of implementing full screening (recommended by Air Force Management Analysis Group [AFMAG]) versus retaining limited screening below a specified dollar threshold. We suggest testing several thresholds, such as $5,000, $2,500, etc., gathering data to compare the savings obtained through reduced parts prices considering the cost of performing full screening with limited screening below each threshold, and establishing the most cost-effective threshold.

b. Adopt AFMAG's recommendation to eliminate assignment of procurement code "L" to spare parts which should receive limited screening.

c. Review and emphasize existing policies and procedures to assure Air Logistics Center (ALC) materiel management data offices aggressively seek missing or incomplete data and correct data restrictions to maximize opportunities for procurement from the actual manufacturer or through competition. (Recommendation 1, Price Replenishment Spare Parts)

(51) Headquarters, United States Air Force (Research, Development, and Acquisition (HQ USAF/RD), in coordination with HQ AFLC, should establish specific policies for the ALCs to follow when negotiating and using formula pricing agreements. As a minimum, the policy should include requirements to:

a. Obtain DCAA audit and contract administration activity technical assistance prior to negotiations to evaluate the contractor's proposed costs, rates, and factors.

b. Perform periodic checks to ensure the contractor is applying the rates and factors specified in the agreement.

c. Perform periodic reviews of the contractor's actual cost data to determine whether the rates and factors agreed to under the formula are providng fair and reasonable prices and, based on the results of the review, adjust the rates and factors as necessary. (Recommendation 2, Price Replenishment Spare Parts)

(52) HQ AFLC should establish the minimum price and cost analysis methods to be applied by ALC buyers for specified dollar levels of spare part procurements and incorporate these standards in AFLC Regulation 70-18. Although latitude for buyer judgment must be allowed, the minimum analysis requirements should at least include criteria for determining when the following levels of analysis are appropriate:

a. Comparison of the proposal with prices of prior buys, catalogs, or similar parts.

b. Comparison to an ALC independent estimate.

c. Requesting a contractor cost breakdown.

d. Requesting contractor prior cost experience for the same or similar part.

e. Validating that the contractor used approved estimating methods and rates and factors.

f. Validating contractor labor hours and material quantity estimates.

g. Requesting field pricing assistance. (Recommendation 3, Price Replenishment Spare Parts)

(53) HQ AFLC should:

a. Instruct ALC procurement personnel on the importance of obtaining DCAA and field pricing technical support when conditions of the procurement are substantially altered (such as large increases in quantity) from the time the last DCAA and field reports were prepared.

b. Ensure tht DCAA and field pricing assistance is being obtained when necessary. One method would be to require the ALC Contract Committee to make this determination as part of its regular reviews of contracting actions. (Recommendation 4, Price Replenishment Spare Parts)

(54) Headquarters, Air Force Contract Management Division (HQ ACMD) should direct the AFPRO commander to intensify supervision over the spare parts contracting process and to specifically:

a. Assure that prior pricing experience with subcontractors is considered in evaluating projected subcontract costs.

b. Require subcontract cost and pricing data be requested when estimates exceed $500,000 and are 10 percent of the total contract and that field pricing support be requested when evaluation of the subcontracted item is critical to evaluation of the prime contractor's proposal.

c. Initiate a post award review of the spare items already awarded to determine if defective pricing data influenced overpricing of items other than the one part identified in paragraph 7c. (Recommendation 1, Pricing Initial Spare Parts)

(55) HQ AFCMD should direct the Air Force Plant Representative at General Dynamics to:

a. Develop, in coordination with the contractor, an appropriate method of distributing the negotiated contract price to individual spares, prior to conclusion of negotiations. Such a method should consistently result in line item prices which represent the understanding reached through negotiations.

b. Review future initial spares contracts, including item prices on the priced spare parts lists submitted by the contractor, to ensure that item prices are consistent with negotiation results as reflected in the price negotiation memorandum (PNM). (Recommendation 2, Pricing Initial Spare Parts)

(56) HQ/AFCMD should:

a. Coordinate AFPRO and contractor efforts to expedite development of an approrpiate provisioning order and processing cost allocation method.

b. Direct the Air Force Plant Representative at Boeing to review future initial spares contracts for item price accuracy until an appropriate allocation method is instituted. (Recommendation 3, Pricing Initial Spare Parts)

OFFICE OF THE ASSISTANT INSPECTOR GENERAL FOR AUDITING

RECOMMENDATONS

We recommend that the Director, Defense Logistics Agency:

(57) Provide guidance to the Supply Centers for obtaining missing technical data from the Services or contractors and for requiring contractors to validate their proprietary claims to technical data. (Recommendation 1)

(58, Require all Supply Centers to establish automated controls that provide supervisory procurement personnel with notification of items that show excessive price increases. (Recommendation 2)

(59) Direct the Supply Centers to buy items in quantities that take advantage of quantity price breaks and give adequate consideration to alternate vendors that want to supply items to the Government. (Recommendation 3)

DEFENSE CONTRACT AUDIT AGENCY RECOMMENDATIONS

In addition to these review results (by Service Audit Agencies') the following comments for improvements in the spare parts procurement system are submitted for the Assistant Inspector General for Auditing consideration in developing audit recommendations.

(60) Total spare parts requirements for each weapon system should be determined using the most current expected or experienced failure rates. Based upon these requirements, spare parts should be ordered in the most economical quantities, commensurate with funding limitations. (Recommendation 1)

(61) Central inventories should be established at the buying commands with perpetual inventory records (preferably with the use of an on-line interactive computer capability) of all spare parts items. The inventory records should be accessible to all who use or order the spare parts. All significant orders for spare parts should be consolidated and coordinated with personnel managing the central inventory control system. (Recommendation 2)

(62) Most of the spare parts items reviewed were for replenishment spare parts. Replenishment spare parts are generally bought in small quantities on an "as needed" basis to meet logistical requirements. These contracts are generally firm-fixed-price and under the current DAR threshold ($500,000) for contract audit. DCAA is currently participating with other DoD elements in a joint study with representatives of Office of the Under Secretary of Defense (Research and Engineering) (OUSDR&E), the Military Services, and DoD Inspector General to determine whether the current $500,000 field pricing support threshold is appropriate. Regulatory action as a result of this study will probably serve to provide adequate audit coverage of these contracts. (Recommendation 3)

(63) DoD has recently placed increased emphasis on component breakout, or purchasing spare parts directly from the original manufacturer instead of from the prime contractor to avoid "pass-through" costs. A more subtle situation exists where this "pass-through" occurs between lower-tier subcontractors. Two or three layers of "pyramided" direct engineering and manufacturing support labor, overhead, G&A, and profit may occur. (Recommendation 4)

In addition to the above 63 audit recommendations, the Inspector General, DoD issued 5 additional recommendations to the Under Secretary of Defense for Research and Engineering. They are:

(64) Update and reissue the contract pricing guidance (Armed Services Procurement Manual No. 1) which establishes the minimum analyses that should be performed at specified dollar thresholds. (Recommendation 1)

(65) Monitor the Air Force's study on performing breakout reviews and reevaluate the $10,000 threshold. (Recommendation 2)

(66) Direct the newly established competition advocates to place priority on examining sole source procurements that are justified on an urgency basis. (Recommendation 3)

(67) Establish a policy for negotiating and using formula pricing agreements. (Recommendation 4)

(68) Develop a uniform definition of air market price for use in determining whether business development expenses have been incurred. (Recommendation 5)

Mr. **Dingell**. How many of them have been implemented by the Department?

Mr. **Sherick**. A lot of them. I would say that we have received a very positive response from the Department. Most of the recommendations were already agreed to before our audit report was in the final stages. The Services agreed that they would take the corrective action.

We buy $22 billion worth of spare parts a year. We looked at spare parts in 1983. In 1984 when we reviewed the price that we were paying for spare parts in 1984 as opposed to the prices we were paying in 1983 and we found a drop in prices of between 11 and 22 percent. There is no question that there was in impact in those price drops.

Mr. **Wyden** [presiding]. We are going to receive a lot of testimony that the spare parts problem has not been solved, and the DCAA started recommending things 2 years ago, Mr. Sherick.

Mr. **Sherick**. I have a series of audits starting right now. Remember, my audit was done before the corrective actions were begun. One of the problems we had in the Department of Defense is every time we did an audit and found some items, the story that came out was, oh, that's an exception, that's a horror story, you know, you found one, those damned auditors, they found a hammer and they want to make a big deal out of it.

One of the things I wanted to do was quantify the problem in the Department because nobody would believe it when we went in and did selective audits. That's why we did the 400-man audit. That's why we did a statistical sampling. Nobody could argue with our coverage. We went to the 202 contractors that provided spare parts. There was nobody who could argue about the validity of that audit and its findings.

Only then did we get people to understand that there was a problem. We could prove it was a problem and it was not just an isolated incident. We proved that we were paying too much for 36 to 53 percent of the spare parts we bought. They were overpriced dramatically in some cases.

Mr. **Sikorski**. Would the gentleman yield?

Mr. **Wyden**. I would be happy to.

Mr. **Sikorski**. Well, then we should have 36 to 53 percent reduction in the spare parts procurement.

Mr. **Sherick**. No. The dollar value was 6 percent. That was numbers of spare parts that were overpriced.

Mr. **Sikorski**. Then we should have a 6-percent reduction.

Mr. **Sherick**. And they said an 11 to 22 percent.

Mr. **Sikorski**. Let me refer you back to the "20/20" piece that you didn't see. In there, there are some pretty good examples of increases of multiples of three, five times increases in those parts. So when you point elatedly to the reductions of 11 to 22 percent, in many of those instances or a least in some of these instances, these are after increases of 500 or 1000 percent occurred.

I agree with you that these things aren't isolated instances, but when you are talking about 11 to 22 percent when we are paying $1,000 for a little screw— —

Mr. **Sherick**. Well, I'm not saying that I'm satisfied with 11 to 22 percent.

Mr. **Sikorski**. Well, it sounds to me like you are saying—and your whole testimony this afternoon has been disturbing in one major area—that, from your blizzard of statistics, things are really great, things are good.

Mr. **Sherick**. No; they are not. You never heard me say that.

Mr. **Sikorski**. Well, that's the impression you sure gave me, and I sat here and listened.

Mr. **Sherick**. I will say this. They are better than they were 2 years ago. But anybody that quotes me as saying that things are good needs their bolts tightened.

Mr. **Sikorski**. Those $1,000 bolts.

Mr. **Sherick**. Yes. I do not believe that things are good. I think there are a lot of problems out there, and that's what I get paid for. You know, I am the IG, not the Messiah. I can do a lot of it in a lot of ways. The criticism here is that I put out the press releases.

Well, part of that press release is to make people sensitive to the fact that we are after them. It is very important that we let them know we are going to get them. The good days are over, and we have learned that. You were asking a witness: What happened in the Department of Defense?

I will tell you what happened. We learned a hell of a lot of bad habits during Vietnam. Everything then was the pressure: get to the part. We didn't care what it cost, just go get it. After the Vietnam war, everybody wanted the big Vietnam dividend in terms of reductions of people. They took thousands of people out of the system. They hooked the computers together with extension cords, and said: computer, you make all those decisions.

The computer did, and it cost us a fortune because we did it on the cheap. People made decisions that we are going to take 2 percent out of this program and 8 percent out of that program and we are going to pull all those people out, pull all that money out, and they did a dumb thing. All I'm saying is they learned those bad habits. The bad habits have not gone away.

Mr. **Sikorski**. You didn't finish the story. Then we took that system, with all its infirmities, we doubled the moneys going into that system and put it geometrically on that system.

Mr. **Sherick**. But we also added a lot of people back into the system over the last 2 years. We have added nearly 6,000 people into that acquisition process for spares, which is good. That's the way it should be.

Mr. **Sikorski**. No, no. That seems to be in reference to my point. You said we had an infirm system with these crazy bad habits.

Mr. **Sherick**. That's right.

Mr. **Sikorski**. And then you stopped there. I simply said we doubled the moneys that we put into that system.

Mr. **Sherick**. Yes, I know. I told you earlier that we took the people out, but we have started to put the people back into those systems. We have competition advocates; we have people out there who are concerned. I'm not saying that they really have learned their lesson yet. All I'm saying is that we are moving in the right direction.

Mr. **Wyden**. Mr. Sherick, we are going to take all these items up in logical order and talk about competition advocates. I think what we are seeing is that the system breeds people like Mr. Modesitt, who came in and told us that he was completely unqualified. I want to get——

Mr. **Sherick**. I agree with that. I did an audit of contracting officers and procurement officials, and I concluded that 67 percent of them were not fully trained, and that the system was not training them.

The other problem I found with contracting officers is they are completely undergraded. They are outclassed by contractor officials. When we get a smart one, as soon as he gets to know the system and is smart enough and doesn't have any desire to be in public service, he moves to the other side of the table.

That is the way it is. What do we do with them? We tried to raise their grades but they are treating them like they are all mailmen; everybody gets paid the same. It is ridiculous.

The other thing is that now they are facing a pay cut. It's a tough job out there. A guy is dealing with a lot of high-priced contractors with a lot of high-priced talent. He's a GS-12 or 13. The pressure is on him. The program manager is hollering that we need these parts for the troops, and he is supposed to sit there and act like John D. Rockefeller.

We have to train and pay them adequately. We have to do the things it takes to do the job. I have been a civil servant or in the military for 43 years. Believe me, there are a lot of good people in the civil service. We have to show them a little respect. You have to pay them properly and you have to train them. That is one of the things we are not doing.

Mr. **Wyden**. Mr. Sherick, on page 22 of the opening statement you gave, you mentioned that in 1984 the Department of Defense suspended or debarred 454 contractors. Who were these large contractors? Were they large ones or small ones? Who were they?

Mr. **Sherick**. They were intermediate and small. It's tough to suspend or debar a big corporation that is the only one that makes submarines for us. That's a tough decision. That's a real management decision for somebody to make. It's only when we have other supply sources that we are going to make that kind of decision.

Mr. **Wyden**. You can do other things besides debar them.

Mr. **Sherick**. Sure. We can get rid of the people.

Mr. **Wyden**. But you didn't do that either?

Mr. **Sherick**. I don't have anything to do with suspension and debarment except for saying that it ought to be done. I'm not in the punishment business. I do investigations and I turn them over and the courts punish them or someone else punishes them. Suspension and debarment is not a punishment. We are merely saying we don't want to do business with a contractor any more.

Mr. **Wyden**. What kind of deterrent do you have, then?

Mr. **Sherick**. We suspend or debar them.

Mr. **Wyden**. Well, on the major contracts, did you recommend that?

Mr. **Sherick**. I haven't had a major contractor in the position. The Secretary just suspended General Electric; I recommended that.

Mr. **Wyden**. I remember hearing something about General Dynamics over the last few weeks.

Mr. **Sherick**. I haven't seen any suspension or debarment action on General Dynamics. I don't initiate it.

Mr. **Wyden**. The Gratuities Board is looking at it?

Mr. **Sherick**. Yes. In my book, I would suspend or debar them. Somebody has to make that decision—we don't want submarines; we don't want F-16's.

Mr. **Wyden**. That, of course, has been the classic kind of argument. That's the argument that leaves the taxpayers powerless, and that's a ridiculous argument.

Mr. **Sherick**. I would suspend or debar individuals. I would just say: get rid of that guy.

Mr. **Sikorski**. Mr. Sherick, the record has to be clear on that part. That's the kind of thing that General Dynamics says to you and to other people when you get upset with what they are pulling. That's not the situation at all.

Mr. **Sherick**. What is the situation?

Mr. **Sikorski**. Under that contract, you can go in there and debar, eliminate a few of those people and keep the system going. So it's not a matter of a submarine or not.

Mr. **Sherick**. Yes, and I would do it. He was talking about suspending the company. I would suspend the individuals. That's what I said. I would go in and pick up the president and say: We want him out.

Mr. **Sikorski**. So it is not a question of a submarine or no submarine; it's a question of David Lewis.

Mr. **Sherick**. I agree. I would say: get rid of him.

Mr. **Wyden**. Are you recommending, then, that Mr. Lewis and Mr. MacDonald be barred personally?

Mr. **Sherick**. If you want my recommendation; I would say yes.

Mr. **Wyden**. Have you made that recommendation?

Mr. **Sherick**. Nobody ever asked me that question, but I will make the recommendation.

Mr. **Wyden**. We just asked you, and I think this highlights the problem, Mr. Sherick. Unless there is a congressional hearing, unless we have taken the steps with our investigators to bring all this out, somehow the system breaks down. The recommendations don't get made, the issues don't get raised.

Mr. **Sherick**. I'm not faulting this hearing. I'm here because I think the inspector general has a relationship with the Congress, and it doesn't matter what committee or subcommittee; the inspector general should take every opportunity he can to come up here and report what is going on.

Mr. **Wyden**. When would you recommend that Mr. Lewis and Mr. MacDonald be debarred?

Mr. **Sherick**. I recommend it now. I don't have any problem with that. I never took a cheese sandwich from a contractor.

[The following documents were submitted:]

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON D.C. 20301

2 MAY 1985

MEMORANDUM FOR SECRETARY OF THE NAVY

SUBJECT: Recommendation for the Consideration of Suspension in Connection with Actions by General Dynamics Corporation Executives

This is to recommend that immediate consideration be given by the Navy, pursuant to the provisions of Subpart 9.4 of the Federal Acquisition Regulation, to a suspension based on improper, and possibly illegal, conduct by three high level officials of the General Dynamics Corporation. The three officials are: Messrs. David S. Lewis, Chairman of the Board, Gordon E. MacDonald, Executive Vice President and Chief Financial Officer, and George Sawyer, Executive Vice President for Land Systems. This recommendation is based on my belief that adequate evidence exists to demonstrate that Messrs. Lewis, MacDonald and Sawyer lack the business integrity and honesty required of high level officials in corporations that do business with the Government.

Information on which I have based my recommendation is contained in three documents:

1. Transcript of hearing before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives, on February 28, 1985 (Enclosure 1);

2. Naval Investigative Service (NIS) Report of Investigation, dated December 20, 1984 (Enclosure 2); and

3. Transcript of hearing before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives, on March 25, 1985 (Enclosure 3).

These documents indicate that Messrs. Lewis, MacDonald and Sawyer have engaged in activities which demonstrate a lack of business integrity and honesty. The activities are summarized as follows:

1. Enclosure 1 contains evidence that indicates that Messrs. Lewis and MacDonald were personally involved in a decision to issue a press release which falsely stated that the first Trident submarine would be delivered in October 1979, when

in fact they knew at the time that it could not be delivered before the end of 1980. The false press release was issued to halt a decline in the value of General Dynamics stock. This may be a violation of 15 U.S.C. 77 q(a) and 15 U.S.C. 78 j(b), of Federal security laws which cover stock manipulation, as well as the requirement for corporate officers to provide full and fair disclosure of information to stockholders and investors.

2. Enclosures 1 and 2 contain evidence which indicates that Mr. MacDonald admitted to directing a General Dynamics employee to purchase two pieces of jewelry, having a value of approximately $1,125, for Admiral Rickover's wife. In addition, there is evidence that Mr. MacDonald discussed the proposed gifts with Mr. Lewis prior to ordering their purchase and delivery. This may have been a violation of 18 U.S.C. 201 concerning gratuities and 10 U.S.C. 2207 which prohibits the provision of gratuities on Government contracts.

3. Enclosure 3 contains facts showing that from March through May 1983, Messrs. Lewis, MacDonald and Sawyer engaged in negotiations concerning the potential employment of Mr. Sawyer. These negotiations occurred while Mr. Sawyer, who was at the time Assistant Secretary of the Navy for Shipbuilding and Logistics, had the authority to and did make decisions affecting General Dynamics. This may be a violation of 18 U.S.C. 207 and 208 concerning conflicts of interest.

4. Enclosure 3 also contains evidence that Mr. Sawyer stated to Navy officials that he had not negotiated for employment with General Dynamics prior to May 20, 1983, when in fact he had begun discussions with General Dynamics regarding employment possibilities as early as March 1983. For example, on March 25, 1983 and May 18, 1983, he traveled to Saint Louis, Missouri, and Chicago, Illinois, respectively, for the purpose of discussing employment possibilities with General Dynamics. These trips were paid for by General Dynamics. This may be a violation of 18 U.S.C. 1001 concerning false statements.

Each of these instances may involve criminal conduct, and clearly raise questions as to the responsibility of Messrs. Lewis, MacDonald and Sawyer as Government contractors. Subpart 9.407-2 of the Federal Acquisition Regulation states that a suspending official may suspend a person based upon adequate evidence of the commission of an offense indicating a lack of business integrity and business honesty that seriously and directly affects the present responsibility of a contractor. In my opinion, adequate evidence of such offenses is present.

Each of the four instances set forth above is under active review by a number of agencies. The first instance regarding manipulation of inside information is the subject of an investigation by the Securities and Exchange Commission and a

Federal grand jury. The second instance relating to gratuities to Admiral Rickover is the subject of a hearing by the Navy Gratuities Board. The Department of Justice is also considering civil action against all parties concerned. The third and fourth instances involving Mr. Sawyer's employment negotiations with General Dynamics are also the subject of a grand jury investigation. The prosecutor in charge of the grand jury investigation has requested that any proposed suspension action in this case be discussed with the Department of Justice, prior to the provision of any formal notice to Messrs. Lewis, MacDonald and Sawyer.

Please be advised that this recommendation is based upon my review of the evidence, as the Inspector General, Department of Defense. I am aware that the Suspension and Debarment Authority of the Navy is required, under Subpart 9.4 of the Federal Acquisition Regulation, to consider a broad range of factors in determining what, if any, action may be appropriate to protect the interest of the Government. If I may provide any further information or advise in this matter, please do not hesitate to contact me or Mr. Michael C. Eberhardt, Assistant Inspector General for Criminal Investigations Policy and Oversight, Office of the Inspector General, DoD, at 694-1234.

Joseph H. Sherick
Inspector General

Enclosures

DEPARTMENT OF THE NAVY
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20350-1000

21 May 1985

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Subj: RECOMMENDATION FOR THE CONSIDERATION OF SUSPENSION IN CONNECTION WITH ACTIONS BY GENERAL DYNAMICS CORPORATION EXECUTIVES

This is in response to your memorandum of 2 May 1985, which recommended that the Navy give immediate consideration to suspending three high level officials of the General Dynamics Corporation. Let me address each case in turn:

(1) Paragraph 1 of your memorandum: "Enclosure 1 contains evidence that indicates that Messrs. Lewis and MacDonald were personally involved in a decision to issue a press release which falsely stated that the first Trident submarine would be delivered in October 1979, when in fact they knew at the time that it could not be delivered before the end of 1980. The false press release was issued to halt a decline in the value of General Dynamics stock. This may be a violation of 15 U.S.C. 77 q(a) and 15 U.S.C. 78 j(b), of Federal security laws which cover stock manipulation, as well as the requirement for corporate officers to provide full and fair disclosure of information to stockholders and investors."

This matter is currently under investigation. Messrs. Lewis and MacDonald have denied these allegations under oath. We shall follow this investigation and take action if warranted on the facts established.

(2) Paragraph 2 of your memorandum: "Enclosures 1 and 2 contain evidence which indicates that Mr. MacDonald admitted to directing a General Dynamics employee to purchase two pieces of jewelry, having a value of approximately $1,125 for Admiral Rickover's wife. In addition, there is evidence that Mr. MacDonald discussed the proposed gifts with Mr. Lewis prior to ordering their purchase and delivery. This may have been a violation of 18 U.S.C. 201 concerning gratuities and 10 U.S.C. which prohibits the provision of gratuities on Government contracts."

The Ad Hoc Gratuities Board has submitted its report to me and I have taken appropriate action by demanding exemplary damages ten times the value of the gratuities and cancellation of two contracts involving more than $20 million. I do not believe that debarment of Messrs. Lewis and MacDonald would be the appropriate response based on the facts established by the Board.

(3) Paragraph 3 of your memorandum stated "Enclosure 3 contains facts showing that from March through May 1983, Messrs. Lewis, MacDonald and Sawyer engaged in negotiations concerning the potential employment of Mr. Sawyer. These negotiations occurred while Mr. Sawyer, who was at the time Assistant Secretary of the Navy for Shipbuilding and Logistics, had the authority to and did make decisions affecting General Dynamics Corporation. This may be a violation of 18 U.S.C. 207 and 208 concerning conflicts of interest."

Mr. Sawyer acted on my behalf as ASN(S&L). From the time he informed me in February 1983 that he was leaving until his departure in June, he made no substantive decision concerning General Dynamics Corporation of which I am aware. Throughout his tenure he performed to the very highest ethical standards and I have no evidence that he knowingly acted in conflict of interest at any time.

(4) Paragraph 4 of your memorandum stated " Enclosure (3) also contains evidence that Mr. Sawyer stated to Navy officials that he had not negotiated for employment with General Dynamics prior to May 20, 1983, when in fact he had begun discussions with General Dynamics regarding employment possibilities as early as March 1983. For example, on March 25, 1983 and May 18, 1983 he traveled to St. Louis, Missouri, and Chicago, Illinois, respectively, for the purpose of discussing employment possibilities with General Dynamics. These trips were paid for by General Dynamics. This may be a violation of 18 U.S.C. 1001 concerning false statements."

These matters are currently under investigation by the Department of Justice. Appropriate action will be taken if warranted on the facts established.

In summary, while I do not agree with your recommendations with regard to Messrs. Lewis, MacDonald, and Sawyer, I have notified Mr. Lewis that we are holding off processing all new contracts with General Dynamics Electric Boat Division and Pomona Division until changes are made. I enclose a copy of my letter to Mr. Lewis.

As in the past, I know we can count on your full support in resolving these problems.

John Lehman

DEPARTMENT OF THE NAVY
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20350-1000

21 May 1985

Mr. David S. Lewis
Chairman of the Board and
Chief Executive Officer
General Dynamics Corporation
Pierre Laclede Center - Room 2004
St. Louis, Missouri 63105

Dear Mr. Lewis:

On 2 May 1985, Mr. Joseph Sherrick, Inspector General of the Defense Department, recommended that I suspend you, Mr. Gorden MacDonald and Mr. George Sawyer under Subpart 9.4 of the Federal Acquisition Regulations.

On March 5, 1985, the Secretary of Defense directed withholding of payments for general and administrative expenses billed by General Dynamics pending resolution of outstanding issues and established three conditions to be met before resuming payment of general and administrative expenses: (1) withholding the additional funds; (2) establishing new billing rates; and (3) General Dynamics' establishing acceptable internal accounting and management practices.

In the meantime, several investigations conducted under Executive Branch and Congressional cognizance have revealed additional facts which call into question the integrity and responsibility of the corporation.

(1) From 1973 to 1981, General Dynamics Electric Boat Division provided cost and schedule information on submarine construction that was grossly inaccurate. Whether such action was intentional misleading of Navy officials, negligence, or merely unwarranted optimism, it was nevertheless continuing evidence of unreliable reporting by General Dynamics Corporation to the Government.

From 1979 until 1981, General Dynamics Electric Boat Division refused to provide cost and performance data on submarine construction to which the Navy was entitled.

In 1981 General Dynamics Electric Boat Division put forward brazen insurance claims against the Navy for their own negligence and faulty workmanship.

From 1977 to 1981, General Dynamics kept Mr. T. Veliotis, currently a fugitive from justice, in charge of submarine construction. By General Dynamics own testimony, this man was unethical and unreliable to say the least. He was reluctantly removed from the Groton yard only when General Dynamics was told there would be no Navy contracts signed while he remained.

(2) Over an extended period of time officials of General Dynamics gave gratuities to Admiral H. G. Rickover, USN (Ret.) with the intent to obtain as favorable treatment as might be possible from the one Government official who could most affect the operations at Electric Boat Division, all in violation of the terms of General Dynamics contracts with the Navy. Ref: Separate letter to you this date.

(3) General Dynamics Corporation has consistently claimed unallowable costs in overhead allocated to Navy contracts. For example, for 1982 the contractor claimed entitlement to reimbursement of such costs as dues and fees paid to over twenty country clubs, social clubs and organizations; contributions and donations to over fifty organizations; lobbying expenses; entertainment; advertising expenses; sunglasses, T-shirts, and flashing hats; expenses of international air shows; and spouse's travel. Indeed, individual memberships in country and social clubs were included in travel expense accounts. You have refused to ~~settle~~ settle disputes on overhead at Electric Boat Division since 1973; at Pomona since 1979, and at Corporate since 1979. All this time you have held disputed amounts, delayed settlement, and accrued the interest.

(4) In 1984 General Dynamics continued to charge unallowable costs to travel accounts to be charged to the Government even though it had committed to shift such charges to company funding. A special audit by DCAA of certain costs being charged from January to August of 1984, showed at least one senior official continuing to be reimbursed for such expenses as spouse's travel, house-sitting and dog-boarding as well as individual memberships and fees of country clubs and social organizations.

In many cases involving disputes on overhead in cases going back at least to 1973, the response by General Dynamics is the same: promises to correct the abuse, and a prompt return to business as usual.

(5) Officials and employees of General Dynamics, Pomona Division used Government classified documents to prepare business proposals and marked the Government's own information with proprietary legends.

Those who have expressed opinions in defense of General Dynamics' conduct have spoken in terms of a superseding obligation to maximize the interests of General Dynamics stockholders. In defending the essential failure of General Dynamics to pay income taxes since 1972, they have asserted that the abundance of legislation, case law and regulation demonstrate the intent of the Congress to permit these practices.

We believe that suppliers to the Government have a public trust and suppliers to the Defense Department have a special obligation to be guided by the highest ethical standards.

The Secretary of Defense's direction to withhold payments of General Dynamics' general and administrative expenses continues in effect. It will not be rescinded until the Secretary is satisfied that the company's shortcomings in its practices concerning overhead billing have been fully remedied. At the same time, I am concerned that the other improper practices of the company set out above that affect the Navy require additional action on my part.

In order to assure that the Department of the Navy will not be subject to these continuing abuses, I am directing Navy contracting officers to hold off further processing of Navy contracts with the Electric Boat Division and Pomona Division of General Dynamics Corporation, pending the accomplishment of certain management changes by General Dynamics. Until these conditions are met no Navy contracting officer can determine that a contract award to General Dynamics Corporation is most advantageous to the Navy, or ~~that~~ its price is fair and reasonable.

Specifically, the following conditions must be met:

(1) Establish and enforce a rigorous code of ethics for all General Dynamics officers and employees with mandatory sanctions for violation.

(2) Resubmit and certify all outstanding overhead proposals.

(3) Negotiate in good faith to achieve final overhead rates in all outstanding disputed cases.

(4) Settle all adjudicated overhead disputes still outstanding with the Navy.

Your prompt efforts to resolve these issues will be greatly appreciated.

Sincerely,

John Lehman

Mr. **Wyden**. Nobody has said anything like that.

Mr. **Sherick**. Believe me, none of them are ever going to hire me. I know. They call me a son-of-a-bitch, and that's fine. You know, that makes me feel good. Unless somebody is hard on them, and unless somebody hits them—and the only way you hit them is in the pocketbook. Believe me, in this building and this Congress, there are as many people putting pressure the other way as there are putting pressure this way. That is what contracting officers are dealing with. That's what all those people are dealing with.

They tell you on the side: "We will get Congressman This or Congressman That." That's what they do to those GS-12s and 13s: "We will call General Somebody." That's the way it happens. You sit here and expect a bunch of GS-12s and 13s to stand up and fight off the whole system.

Mr. **Wyden**. How have you hurt anybody in the pocketbook? How have you hurt a major contractor in the pocketbook?

Mr. **Sherick**. We just changed progress payments, and that hurt them.

Mr. **Wyden**. Who did you do that to?

Mr. **Sherick**. All of them. We reduced the rate of progress payments from 90 to 80 percent for large businesses and from 95 to 90 percent for small businesses.

Mr. **Wyden**. Has anybody seen any loss of business?

Mr. **Sherick**. There is no loss of business, but, by God, it sure gets them in the pocketbook. We recommended a refund of $167 million from General Electric. I can't go out there with a gun and get it. I just think they owe it to us. We recommended a refund of $38 million from Pratt & Whitney.

Mr. **Wyden**. Have you gotten it?

Mr. **Sherick**. No, I don't go get it. I recommend that the Department get it.

Mr. **Wyden**. Nobody got it? The taxpayers didn't get it?

Mr. **Sherick**. If Congress wants to authorize me, I have 200 agents with guns; we will go get it.

But that's not my job. My job is to say I think these people cheated; and their attitude is: We stole it fair and square and we are not going to give it back.

Mr. **Wyden**. I guess the only conclusion I would make is that we need to get the Secretary, Secretary Weinberger, up here to find out why your recommendations are being bucked.

Mr. **Sherick**. He is not bucking any of my recommendations.

Mr. **Wyden**. Well, nobody is hitting the pocketbook.

Mr. **Sherick**. Yes, he did. He changed the progress payments. He suspended General Electric on the basis of my recommendations. They were my audits.

Mr. **Wyden**. What have they been restricted from?

Mr. **Sherick**. The Secretary is the most important man to me in the world. He never abuses me, which I can't say for a lot of people, and he is very supportive. As fast as I can bring on people and train them adequately and get good people, he has increased my staff. Right now I have 50 open auditor positions. I have 59 open criminal investigator positions. I am killing myself to hire those people.

BEST COPY AVAILABLE

I have got a plan that is going to get me 400 more criminal investigators. It's just a question of getting them. It's tough to get good people. I have seven children, and none of them work for the Government. I don't think any of them ever will, because they say to me: Dad, why do you take all that crap off people?

Mr. **Sikorski**. If the gentleman would yield.

Mr. **Sherick**. The point is, if you don't get good people in this Government, with what they are up against from the contractors, it will be tough to operate an effective procurement system. I'm not saying all the contractors are bad. We couldn't operate that Department of Defense for 5 minutes without contractors. We have a hell of a lot of good contractors, but we have got some others that aren't very good.

Mr. **Sikorski**. That is the point. The point is the good contractors benefit from regulations that are honestly applied and strictly enforced, and the bad apples weeded out. But it's the flip side.

I want to get back to something.

Mr. **Sherick**. Well, let me make one more statement.

Mr. **Sikorski**. No. You made the statement that the Secretary of Defense backed you up and you barred General Electric.

Mr. **Sherick**. The Air Force suspended General Electric.

Mr. **Sikorski**. You suspended General Electric. Then a couple of days later, they got another contract?

Mr. **Sherick**. Yes, sure, they got another contract.

Mr. **Sikorski**. Oh, yes, hit right in the pocketbook. Boy, they rolled and rolled. They were hit right in the pocketbook.

Mr. **Sherick**. It was a shutdown of a major Air Force operation, which was an overhead program.

Mr. **Sikorski**. You said you hit them in the pocketbook, but as it turns out, you put more money into that pocketbook.

Mr. **Sherick**. I didn't give them any money. They wouldn't have got 5 cents from me.

Mr. **Sikorski**. You said Defense was backing you up all the way. Just gave them more money. Where's that backup? And then 30 days later they pulled the suspension, right?

Mr. **Sherick**. I recognize the responsibility that he has.

Mr. **Sikorski**. Mr. Sherick, then the suspension was pulled 30 days later. Right?

Mr. **Sherick**. Yes, because General Electric agreed to take corrective action.

Mr. **Sikorski**. They agreed to be a little honest.

Mr. **Sherick**. I hope so.

Mr. **Sikorski**. Yeah, boy, they were hit in the pocketbook.

Mr. **Sherick**. I think they were.

Mr. **Sikorski**. How many dollars?

Mr. **Sherick**. I don't know. I'm after $167 million.

Mr. **Sikorski**. Well, the truth is they weren't hit a single cent. They were suspended, they got a contract within days, and the whole thing was pulled.

Mr. **Sherick**. I'm not up here to defend Caspar Weinberger.

Mr. **Sikorski**. You just defended him.

Mr. **Sherick**. No, I just told you what he is doing for me.

Mr. **Sikorski**. And you said it was a great job; and the facts don't prove it.

Mr. **Sherick.** No. Supporting me is a good job. I have got to give the man credit. He is.

Mr. **Sikorski.** Mr. Sherick, you are aware that President Reagan's statement says he wants IG's that are meaner than junkyard dogs to ferret out waste, fraud, and mismanagement; right?

Mr. **Sherick.** Yes, that's me.

Mr. **Sikorski.** And you have heard of Fursten?

Mr. **Sherick.** Yes, I've heard of him.

Mr. **Sikorski.** I would submit that there are pampered poodles spraying all over your mean junkyard dogs down there.

Mr. **Sherick.** Well, I don't agree with you on that and I don't think it's fair. I think it's unjustified. I think that when you say things like that, you are doing just a little bit more to the civil servants and everybody else who works for the Government.

Mr. **Sikorski.** Mr. Sherick, you will never find me critical of civil servants, either generally or specifically, unless in specific instances they have—I don't talk about bureaucrats, spitting it out as if it were a terrible thing. I sit on Post Office and Civil Service, chairman of the Investigations Subcommittee, and I spend a lot of time defending civil servants from the type of cheap shots you are talking about So you won't find me saying that; but when the shoe fits.

In terms of where the proof is in the statistics, where have you hit those major contractors? You cited one example that I just explained to you doesn't even hold up.

Mr. **Sherick.** I just think that our audits, cutting for instance, the price of spare parts, hit them in the pocketbook. I think there are a lot of places where we have hit them in the pocketbook. I will be glad to give you the savings that we have created.

[The following document was received:]

8 MAY [illegible]

OFFICE OF THE ASSISTANT INSPECTOR GENERAL
FOR AUDITING
REPORTED COST SAVINGS
FY 1984

REPORT NO.	TITLE	REPORTED SAVINGS (Dollars in Millions)	CONCURRED IN BY MANAGEMENT (Dollars in Millions)
84-010	Report on the Audit of Contracts for Automatic Data Processing Support Services	$ .2	$ .2
84-012	Report on the Audit of Army Pre-Positioned War Reserve Materiel	89.0	89.0
84-019	Report on the Audit of DoD Scrap Operations	9.1	9.1
84-026	Report on the Audit of Air Force Missile Maintenance Manpower Requirements	86.0	*
84-027	Quick-Reaction Report - Breakout of High-Dollar Value Helicopter Parts Under Contract Between Naval Air Systems Command and Kaman Aerospace Corporation	2.7	*
84-029	Quick-Reaction Report on the Audit of Procurement Operations in the Pacific	1.3	1.3
84-031	Report on the Audit of Used Solvents	10.3	*
84-050	Report on the Audit of the Department of Defense Dependents Schools Organizational Structure and Staffing	5.2	*
84-059	Memo Report on the Review of Temporary Housing Costs for Enlisted Personnel During Barracks Renovation	1.4	*
84-070	Report on the Audit of the Implementation of Office Automation at the Defense Communications Agency	1.1	1.1
84-074	Report on the Audit of the Tactical Troop Cargo Vehicle Requirements (U)	182.0	182.0
84-075	Report on the Audit of Selected Air Defense Systems Requirements	245.1	245.1
84-080	Report on the Audit of Base Communications	47.1	47.1

* Not Verified/Pending Resolution

6 MAY 1985

REPORT NO.	TITLE	REPORTED SAVINGS (Dollars in Millions)	CONCURRED IN BY MANAGEMENT	
84-089	Audit of Selected Aspects of the Defense Intelligence Agency Travel Program	$ .3	$ .3	
84-091	Audit of Pricing of Missiles Sold to Foreign Military Sales Customers	26.2	*	
84-092	Audit of Pricing Support for Spare Parts Provided by the Defense Contract Administration Services	7.2	*	
84-093	Audit of Supply Support for DoD Commercial Design Vehicles in the Pacific	.1	.1	
84-096	Report on the Audit of DoD Computer Timesharing Services	.2	.2	
84-099	Quick-Reaction Report on the Audit of Rent-Plus Housing Allowance Program in the Pacific - Rental of Commercial Hotel Rooms in Hawaii	.5	.5	
84-105	Report on the Audit of the Financial Reports and Credit Program Division, Defense Security Assistance Agency (U)	82.7	82.7	
84-107	Report on the Audit of Contract Automatic Data Processing Support in Europe (U)	3.8	*	
84-111	Management and Administration of the Uniformed Services University of the Health Sciences	21.3	21.3	
84-121	Report on the Survey of CHAMPUS Billings and Payments	.1	*	
84-124	Report on the Outside Employment and Clinical Investigations by DoD Doctors	.1	.1	
84-125	Report on the Audit of Industrial Security Costs at DoD Contractors' Plants	26.8	26.8	
84-126	Report on the Audit of the SGT York Division Air Defense (DIVAD) Gun System	83.6	19.0	64.6*
84-128	Acquisition of New Special Airlift Mission Aircraft	60.0	*	
84-139	Report on the Audit of Graduate Education Programs	6.6	*	
	TOTALS	1,000.0	725.9	

* Not Verified/Pending Resolution

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8 MAY 1985

OFFICE OF THE ASSISTANT INSPECTOR GENERAL
FOR AUDITING
REPORTED COST SAVINGS
FY 1985

REPORT NO.	TITLE	REPORTED SAVINGS	CONCURRED IN BY MANAGEMENT	
		(Dollars in Millions)		
85-005	Report on the Audit of the Automation Resources Management System	$ .3	$ *	131.4
85-006	Report on the Audit of the Pricing of Technical Assistance Sold to Foreign Military Sales Customers	316.0	184.6	
85-007	Defense Nuclear Agency/Multi-Agency Cooperative Electromagnetic Pulse Hardening Technology Program	2.6	2.6	
85-010	Audit of Commercial Computer Time-Sharing in the DoD	1.2	1.2	
85-013	Report on the Audit of Controls Over Property at Repair and Overhaul Contractor Plants	16.8	16.8	
85-015	Report on the Audit of Selective Reenlistment Bonus Recipients Assigned to Recruiting Duty	.1	.1	
85-029	Audit of DoD Contract Studies and Analyses, and Professional and Management Services	1.5	*	
85-049	Special Duty Assignment Proficiency Pay for Recruiting Personnel	6.5	6.5	
85-051	Audit of Center of Influence Programs in Support of Recruiting	1.0	1.0	
85-053	Report on the Audit of Controls Over Items Imported by DoD Contractors	.1	.1	
85-056	Report on the Audit of Plant Equipment Packages	13.7	13.7	
85-057	Report on the Audit of Materiel Management of Numeric Stockage Objective Items by the Defense Logistics Agency	91.8	91.8	
85-061	Audit Report on Initial Provisioning at the National Security Agency (U)	.7	.6	[illegible]
85-066	Audit Report on Use of Project Orders for Repair of Defense Logistics Agency Stock	.1	.1	

* Not Verified/Pending Resolution

8 MAY 1985

REPORT NO.	TITLE	REPORTED SAVINGS (Dollars In Millions)	CONCURRED IN BY MANAGEMENT (Dollars In Millions)	
85-068	Report on the Audit of the Rent-Plus Housing Allowance Program in Hawaii and Alaska	$ 49.5	$ 37.1	12.4
85-073	Report on the Audit of the Joint Service Advanced Vertical Lift Aircraft (JVX) (U)	60.0	60.0	
85-079	Quick-Reaction Report on the Breakout of Component Parts Procurement at the U.S. Army Missile Command	.2	*	
85-081	Report on the Audit of Aircraft Engine Spare Parts Pricing, Costing, Negotiation and DoD Review Functions	205.0	*	
85-085	Report on the Audit of Supersonic Sled Tracks	53.0	51.8	1.2
85-086	Report on the Audit of the DoD Policies on the Use of Progress Payments	230.0	230.0	
	TOTAL	1,061.8	698.0	

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Mr. **Sikorski**. I thank you for those savings, and I want to lend encouragement to anything you can do in that area. If you want someone to make a speech on behalf of your people getting tough, I will come and make the speech. If you want me to carry legislation, you want me to do something on authorization or appropriation, you just call. If you want backup, I will give you backup for this kind of approach. But I want results from it and not a statement saying the waters are calm.

Mr. **Sherick**. I'm not saying the waters are calm. If you want to be nice to me, take me to Lake Woebegone sometime.

Mr. **Sikorski**. Yeah, that's in my district.

Mr. **Sherick**. Is it? OK, fine.

Mr. **Wyden**. Let's move on.

I think the reason we are here——

Mr. **Sherick**. You know, I'm starting to think that maybe the defense contractors put you up to this.

Mr. **Wyden**. I think the reason we are here is that our constituents look at all these transactions and they think their pockets are getting empty.

Mr. **Sherick**. Sure. I look at them, too. I think it's my pocket. That's what I feel. I see these guys spending money like that and I look at how much I pay income tax. I have seven kids, and I resent all that. I really do. That is why I get very sensitive about people that dump on the contracting officers and dump on everybody else. I don't think that's the problem.

There are a lot of problems and there are a lot of fixes that have to be made. You can't blame it on just one thing. The media is a perfect example. You go after a contractor. You don't see a lot in the paper because the IG is not buying full-page ads with his battleship coming over the horizon.

In this case in Pittsburgh where I was attempting to enforce my subpoena, I received no good stories, none that I felt told my part of the problem. It was like here is Atilla the Hun trying to take poor little Westinghouse, in there making their little lightbulbs, to the cleaners with his 80,000 troops. It just wasn't that way; but that is the way the stories come out. As I say, I don't take a back seat to anybody.

Mr. **Wyden**. Let's talk about your role in Pratt & Whitney. Yesterday at our hearing, I think you are aware that Mr. Cavanaugh, the special agent of the FBI in West Palm Beach, testified that DOD-IG, Defense Criminal Investigative Service and the Office of Special Investigations of the Air Force are involved with the FBI in the investigation of Pratt & Whitney in West Palm Beach.

Is the DCIS IG and the OSI involved with the FBI in this?

Mr. **Sherick**. Yes, they are. In fact, it was our investigation that had started out that way. We went there to investigate Mr. Spanton, and our investigator concluded that there was nothing wrong with Mr. Spanton. There was a hell of a lot wrong with Pratt & Whitney. At that point we got the FBI involved because we didn't have any agents in that area. That is how the case then moved to the FBI and to the U.S. attorney in Miami.

Mr. **Wyden**. What kind of information has been supplied, though?

Mr. **Sherick**. From me? The case is in the grand jury. I don't really know everything that is there under rule 6[E], but I think the whole thing was worked on.

Mr. **Wyden**. But you submitted a number of cases on gratuities to military officers, didn't you?

Mr. **Sherick**. That was the first thing we looked at. It was pretty much consolidated in the case.

Mr. **Wyden**. Has any action been taken on those matters?

Mr. **Sherick**. As I say, I think the thing is in grand jury. The U.S. attorney in Miami has it. I have written a couple of letters trying to get them to move on it, but I can't get much action. I am not pleased with the progress of that case. I'm willing to do whatever I can to move along.

Mr. **Wyden**. Do you think the U.S. attorney or the assistant U.S. attorney is dragging their feet in that matter?

Mr. **Sherick**. Yes, I do. I don't know why. But when you discuss Florida, you must consider drugs, bank robberies, and a number of other things. You must understand, Mr. Wyden, our cases are not simple. They don't have jury appeal. It is necessary to deal with thousands of vouchers and contractor records. A case can go for 6, 8, 10 weeks.

Well, a U.S. attorney can get five bank robbers in a day, you know, and convict them and send them away, and God knows how many drug pushers. When we confront him with a very complex case we are trying to get the U.S. attorneys and the assistant U.S. attorneys to understand our cases and to let them understand that we are willing to devote the audit and investigative support—whatever is needed to help them understand a case—so that they can prosecute it and win it.

When we walk into U.S. attorney's offices with 3 tons of records, we have just lost their attention unless we have some real good reason for getting their attention.

Mr. **Wyden**. Let's talk about this a little further because I think this is an extremely important area. It seems to me that you have again exposed a major flaw in the system, and that is that these U.S. attorneys and these assistant U.S. attorneys don't seem to consider these defense cases priorities, even though we are talking about millions and millions of dollars.

Now, you have the power to go to Mr. Meese, for example——

Mr. **Sherick**. I have.

Mr. **Wyden**. On that?

Mr. **Sherick**. Not on that one, but I went on General Dynamics. In fact, I sent a letter to the Justice Department on 28 different cases. I don't go to Mr. Meese. I don't discuss cases at that level, but I talk below Mr. Meese to Steve Trott and people like that. And, of course, we have the Defense Procurement Fraud Unit, with which we can deal with directly.

Mr. **Wyden**. What does either Mr. Meese or Mr. Trott say when you go to them?

Mr. **Sherick**. They agree with us. I haven't talked to Mr. Meese, but as I say, Mr. Trott certainly has been very supportive. He has said that we must get those U.S. attorneys going. In the Defense Procurement Fraud Unit, there are I think, 13 attorneys. I would like to see it have 70.

Mr. **Wyden**. What did you tell the Justice Department about the General Dynamics case?

Mr. **Sherick**. Well, that's the one that was hanging up. That was the shipbuilding settlement. I just said that I couldn't understand why it was hanging up. The only thing we can do is press, be a pain in their butt. That's about all we can do, and we just have to keep that kind of pressure up.

And they do have other priorities. I'm not saying they don't. They have plenty of priorities.

Mr. **Wyden**. Are you talking about the 1981 case?

Mr. **Sherick**. Yes, the shipbuilding case.

Mr. **Wyden**. On the claims?

Mr. **Sherick**. Yes. As a result of my going to them, that is one of the reasons they established the Procurement Fraud Unit, so that we could get some attention. As I say, I think the Procurement Fraud Unit ought to have 70 lawyers. I keep saying that.

Mr. **Wyden**. Let's go back to Pratt & Whitney. You said you felt the U.S. attorney or the assistant U.S. attorney down there was dragging their feet, that it was taking longer than it should, and the Pratt & Whitney matter——

Mr. **Sherick**. I say that about almost all of them. I want to get my cases tried, for a lot of reasons. I want those guys to go in the slammer, and I want people to know we are going to get them. If we are just a pussycat—in other words, if we can't produce, then we can conduct all the investigations in the world and nobody is going to get scared.

Mr. **Wyden**. Are you concerned that the statute of limitations is going to run out next year on Pratt & Whitney?

Mr. **Sherick**. Yes, absolutely.

Mr. **Wyden**. So tell us what you are going to do. Assuming the U.S. attorney still drags his feet down there and this thing just goes on and on, how are you going to turn it around?

Mr. **Sherick**. Well, my next step is to get Secretary Weinberger to write to the Attorney General, Meese.

Mr. **Wyden**. So you would mention it to Mr. Weinberger and then he could visit with Mr. Meese at the next Cabinet meeting and you would be off to the races?

Mr. **Sherick**. No, I would put it in writing. We have to write a letter. We get action on letters.

Mr. **Wyden**. We would like a copy of that when you send the letter.

Mr. **Sherick**. I will be glad to.

[The following document was submitted:]

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

Honorable Stephen S. Trott
Assistant Attorney General
Criminal Division
Department of Justice
Washington, DC 20530

Dear Mr. Trott:

In light of the recent attention given to delays in reaching a prosecutive decision on the investigation of Pratt and Whitney, I would recommend that an examination be conducted of the current inventory of cases in the United States Attorneys Offices to identify other potentially significant investigations which may have been unnecessarily delayed. While many of these investigations involve complex issues of law and fact, I am sure you share my concern that individual United States Attorneys appreciate the need for timely disposition of these cases.

Therefore, besides urging you to ensure that an immediate decision is rendered regarding the prosecution of Pratt and Whitney, I have asked Mr. Michael C. Eberhardt, my Assistant Inspector General for Criminal Investigations Policy and Oversight, to work with the Defense Procurement Fraud Unit to identify the status of all investigations involving the top 100 Department of Defense contractors.

I would hope that our concerted efforts to avoid delays in significant cases will ensure that all United States Attorneys develop an understanding of why Department of Defense procurement fraud cases must be viewed with the greatest priority.

Sincerely,

Joseph H. Sherick
Inspector General

OAIGCIPO/MCEberhardt/ca/4-30-85
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Mr. WYDEN. Let me turn to another area, the question of problems in getting DCAA records. Mr. Sherick, in the testimony that was given to the subcommittee yesterday by Mr. Spanton, he cited a Baltimore Sun article on March 1, 1984 which reported that the IG had complained in the summer of 1983 that an agreement between the IG and the then Comptroller, Mr. Puritano, if I am pronouncing that right, to provide access to data was being ignored by the DCAA.

The IG is reported to have said that DCAA had delayed reviews, withheld information, attempted to control the scope of the investigation, and ignored agreements for access to files. The DCAA appears to consider our review a game in which they see how much can be kept from us by providing the bare minimum of data, and then only if we persist in asking for it.

Now, is that Baltimore Sun article correct?

Mr. SHERICK. That's right. That's what I said. And that was the early introduction of the IG. It got straightened out.

Mr. WYDEN. Did you prepare a report?

Mr. SHERICK. Yes, sir. I mentioned it in my statement.

Mr. WYDEN. You will furnish us a copy?

Mr. SHERICK. You have a copy, I am sure. We have provided all those reports.

Mr. WYDEN. Please describe the nature of this agreement with the DOD Comptroller. The reason I ask is: Why couldn't you just ask the DCAA for any information that you required?

Mr. SHERICK. I did, and DCAA didn't give it to me.

Mr. WYDEN. They did or did not?

Mr. SHERICK. They did not. The Comptroller runs DCAA. They are an organization under him, and he is their boss. That is why I went to the Comptroller.

Mr. WYDEN. Who in DCAA is denying you or is delaying or otherwise hampering your investigations?

Mr. SHERICK. Well, you have to understand, the IG was the new boy on the street. People were trying him on for size everywhere. They weren't used to an IG. They had a 200-year lead on the IG. Consequently, when we went after them for anything, no matter who we were or what we were, they wanted to see who we were. I started carrying copies of the IG Act, and I had all my people carrying them so they could say: Read it. It was not just DCAA; it was all over. People were saying, Who are you? And we had to let them know who we were. The way I let them know was to ask politely. If they didn't respond, I hit them over the head with a baseball bat. That's the way I operate. Basically that's what I had to do.

Mr. WYDEN. Is DCAA now denying or delaying?

Mr. SHERICK. No.

Mr. WYDEN. My understanding was that you told Secretary Weinberger that people were not cooperating.

Mr. SHERICK. Not recently.

Mr. WYDEN. When did you tell Secretary Weinberger that?

Mr. SHERICK. Two years ago.

Mr. WYDEN. So now they are?

Mr. SHERICK. Absolutely. Not only are they being cooperative; they are being very supportive. They are helping us with a lot of our spare parts audits wherever contractors are involved. You may not know it, but 3 weeks ago I was up in the other body being accused of being Attila the Hun going after contractors. Two of the major Defense contractors were testifying that I was overrunning them with auditors. I had to sit over there for an hour and defend myself against that kind of charge.

The IG is a new concept. Everybody tries you on for size. I am willing to take that kind of heat. I will go to war with anybody.

Mr. WYDEN. Why didn't the DCAA people tell you about General Dynamics and Mr. Burch and all these other things that you seem to get——

Mr. SHERICK. I told you they are telling me now. They are starting to give me those forms. They just weren't reporting the fraud that they found. You will have to talk to Mr. Starrett about that. One of the things you have to understand is that DCAA feels that they are auditors, not criminal investigators, and they tend to think that way.

Mr. WYDEN. They are Federal employees.

Mr. SHERICK. That's what I always say.

Mr. WYDEN. Mr. Sherick, this was 3 months ago.

Mr. SHERICK. What?

Mr. WYDEN. The General Dynamics corporate aircraft——

Mr. SHERICK. They may have referred it. They don't do it just to me. They do it to my criminal investigators. I know we have cases against General Dynamics.

Mr. WYDEN. But you are responsible for your criminal investigators.

Mr. SHERICK. Yes; but you see, one of the criticisms I made to DCAA on referral of fraud information was that the system they had, everything went up through the whole parade, up to the Pentagon and then over and down to my office. By the time it got down to the criminal investigators on the ground, it was so old that they had lost valuable time.

One of the changes I recommended was that they pass these kinds of referrals directly across and not go through the big parade of going all the way up to the top and then over and then down. If they see somebody stealing or see something that's fraud, they go right to the local Defense criminal investigative agent or to the local OSI or right to the local NIS or the local CID agent.

The whole process of going up and down was a time-consuming problem that let people get off the hook.

Mr. WYDEN. Mr. Sherick, just one last question and I want to give my colleagues, certainly, their time.

Do you think we are going to be able to clean this process up unless we put civilians in charge of procurement?

Mr. SHERICK. Well, there are a lot of good military people. Some of the best program managers I ever ran into were military. Dodd Starbird, who was a program manager on safeguard, was one of the most capable. Joe Kelly, who was program manager on SOSUS was another.

I don't think it has anything to do with whether they are military or civilian. It has to do with stability. You put people in jobs and you keep them there. They must be given a sense of responsibility and stability. For the military, the reward that they would get if they were moving through the system, in terms of promotions.

I think we have got a hell of a lot of well-trained military people. We can't make it amateur night. You cannot keep changing people every 18 months. It takes a person 18 months to learn a job. The next thing you know: Bang, where did he go? He is off to a brigade somewhere. Why did you send that man to a brigade? Because he has to have that if he is going to be a general.

I think John Lehman just changed the rules in the Navy on that. The present system doesn't make sense. We should either keep them out of the system or put them in. I think they add a flavor to the system that is very good and very important.

Mr. SIKORSKI. Mr. Sherick, your staff has advised the committee staff that the IG Office promotes the concept of global settlements. Is that an accurate analysis?

Mr. SHERICK. No, I don't. I saw that and I said I don't.

Mr. SIKORSKI. You personally don't. Then why is this concept going on?

Mr. SHERICK. I don't know. I do not support global settlements, believe me.

Mr. SIKORSKI. Well, I like your spirit, and I want to be supportive of where you are going, and I think you add a real positive note. We are all trying to work together.

Mr. SHERICK. Sure. That's why I'm here.

Mr. SIKORSKI. Well, the global settlement concept, as I understand it, is one where you wrap up all the civil, criminal, and the whole auditing and any kind of outstanding problems into a nice little package and then sign off on it. There are a lot of indications where they go in and the contractors end up getting more than was originally questioned in the first place.

Mr. SHERICK. Yes. It's sort of like they are guilty of murdering their mother and parking in a no-parking zone; they end up getting found guilty of parking in a no-parking zone, and the rest of it goes.

Mr. SIKORSKI. And they get a tax rebate on top of it.

Mr. SHERICK. Right. I say put them on the stand and let's go.

Mr. SIKORSKI. Well, why does your staff think that this is a policy——

Mr. SHERICK. I don't know. I'm going to have to ask my staff.

Mr. SIKORSKI. I hope you apply the same spirit——

Mr. SHERICK. Oh, I do.

Mr. SIKORSKI. Good.

Who on your staff supports this global settlement idea?

Mr. SHERICK. I don't know. I don't know where it came from. I saw that paper last night at home when I was reading that stuff. Not me.

Mr. SIKORSKI. Was Sperry an example?

Mr. SHERICK. Yes; that was a bad example. I thought that was really bad. So did the judge. Judge Lord, I think, up in your area, dumped all over that guy, and he should have. I thought that was just a lousy settlement.

Mr. SIKORSKI. Well, once again for the record, tell us the problem with global settlements as you see them.

Mr. **Sherick**. The problem I have with global settlements is we shouldn't settle. What they attempt to do is wrap up not only everything that we know about but also everything we don't know about. That's ridiculous. Just because we don't know about all those crimes, to say that, hey, since we didn't find it out yet, we are going to say you are completely innocent, or we are going to let them off, it just doesn't make any sense to me.

I can understand a settlement that can be worked out with a judge on a plea bargain on what we know, but in a global settlement they try to say we won't suspend or debar you. What right does a court settlement have to determine whether they are good providers or suppliers or not. I don't think that that should happen. That is sort of going to confession, you know, and getting the whole works.

Mr. **Sikorski**. Well, then what happens when you get a situation like we had in Sperry? Is it just a sellout on it or what?

Mr. **Sherick**. I don't know that they sell out. Everybody wants us to settle cases. That's my problem. You know, I don't feel that way. I feel that you either believe in the system or you don't. Now, I understand that the courts are crowded. There are all kinds of problems, you know, and I can appreciate all that, but believe me, when I think that these people do the things that they do, and the amounts of money they get, they ought to get on the stand and somebody ought to give them hell.

Mr. **Sikorski**. And when you take the attitude you have expressed here that that dollar should be treated like a dollar out of your pocket, then you don't get to global settlements. So from this day forward, global settlements are not a policy of the inspector general.

Mr. **Sherick**. It's not. It never was.

Mr. **Sikorski**. OK.

Mr. Sherick, I note in your publication, "The Indicators of Fraud in the Department of Defense Procurement," that you state that the fraud most frequently encountered by DCAA auditors is called accounting mischarges. You explained that this involves knowingly charging unallowable costs to the Government, concealing or misrepresenting them as allowable costs, or hiding them in accounts which are not audited closely.

You also state that DAR 15-205 and FAR 32.205 includes as unallowable costs such things as entertainment and contributions and donations. Are we OK so far?

Mr. **Sherick**. Yes.

Mr. **Sikorski**. The subcommittee's recent hearings with Mr. Lewis and Mr. MacDonald showed that General Dynamics has been charging the Government and the American taxpayers for country club dues, golf fees, lavish dinners and parties, chili cookoffs, entertainment of military officers. GD also contributed $1,000 in March 1982 to the congressional club's annual chili cookoff. Mr. Lewis said he thought this might have some charitable connotation.

Even if it were for charity, can General Dynamics legitimately charge $1,000 to the Government?

Mr. **Sherick**. I don't know. I'm not that knowledgeable on contributions. You will have to ask DCAA. But I would say no.

Mr. **Sikorski**. The same thing with entertaining military officers and other Government employees by paying for dinners and golf balls.

Mr. **Sherick**. No; those are gratuities. That's bad.

Mr. **Sikorski**. Musical events?

Mr. **Sherick**. Yes. No way.

Mr. **Sikorski**. And wouldn't, therefore, any attempt to get paid for these types of things from General Dynamics be fraud, or what is called accounting mischarge?

Mr. **Sherick**. Yes. If they certify it as allowable costs, I would say yes, it is a fraud.

Mr. **Sikorski**. Well, the Secretary of Defense on March 12 announced with great fanfare that they are going to have a certification under penalty of perjury for these kinds of charges. Then there was a movement back, a clarification that it wouldn't involve any criminal penalties, and then most recently it said it is only going to occur at final settlement. That is not satisfactory, is it?

Mr. **Sherick**. I thought the certificate was a good idea because as the GAO people said, everything is there. But this was a shot across the bow of the contractors. That is basically what it was. And it put them on notice that the burden has shifted, that you have to certify to these claims precisely and specifically.

Mr. **Sikorski**. What was the notice when they said that no criminal prosecution would entail, then?

Mr. **Sherick**. I don't know. I just didn't agree with that memo.

Mr. **Sikorski**. Then what was the notice to the contractors when they were pulled back to now it's only at final settlement? This is after all these kinds of discussions.

Mr. **Sherick**. Yes. I just thought the memo didn't add anything.

Mr. **Sikorski**. Do you still think it's a good idea to make the contractors——

Mr. **Sherick**. Yes, absolutely.

Mr. **Sikorski**. Just like you and I have to do when we——

Mr. **Sherick**. Absolutely.

Mr. **Sikorski**. When you learn of a contractor furnishing significant gratuities to DOD civilian and military personnel, dinners, fishing trips, expensive gifts, vacation travel, have you been able to obtain DOJ's interest or support in prosecuting the contractor?

Mr. **Sherick**. No; not really. We are going to have some real cases soon that will test that, but generally we don't get their attention.

Mr. **Sikorski**. It's the DOJ's public integrity section and the DPFU that have refused to consider these cases?

Mr. **Sherick**. Well, I don't know. I can't be sure of that. But I do know that you don't get an indictment or a conviction. They consider them, but I don't know that anything ever happens.

Mr. **Sikorski**. They consider them in a very broad and modest——

Mr. **Sherick**. They may even consider them specifically and precisely, but I never see anyone going to jail. I haven't seen anyone yet.

Mr. **Sikorski**. It's unsatisfactory to you.

Mr. **Sherick**. Right.

Mr. **Sikorski**. Don't you think it is absolutely necessary, if we are going to stop the pervasive problem of accounting mischarges or what you call fraud that there is going to have to be some prosecution?

Mr. **Sherick**. Absolutely.

Mr. **Sikorski**. What are you going to do about it?

Mr. **Sherick**. I have people out there doing defective pricing audits like crazy. I have criminal investigators. I have 427 contract fraud investigations underway, and I keep pounding the Procurement Fraud Unit.

Mr. **Sikorski**. Well, I appreciate that, but once you get to this lack of interest——

Mr. **Sherick**. The only thing we can do from that point on is make a lot of noise.

Mr. **Wyden**. Will the gentleman yield?

Mr. **Sikorski**. Sure.

Mr. **Wyden**. Did Secretary Weinberger help you out in those kinds of instances?

Mr. **Sherick**. Sure. I think if I went to him, he would help you out.

Mr. **Sikorski**. Are you going to try it soon?

Mr. **Sherick**. Yes. That man will sign almost anything that I put in front of him in support of my program. I cannot say that he is not very supportive. He is. He just gets up to here with these contractors. They are very insensitive to us and to our department, I think.

Mr. **Sikorski**. Well, someone is very sensitive to the contractors. They complained about the certification process.

Mr. **Sherick**. Oh, they complained about me. I told you that.

Mr. **Sikorski**. The Department backed down two or three times.

Mr. **Sherick**. I don't think it was backed down. I think the certificate is there. That is the way it is and that is the way it is going to be.

Mr. **Sikorski**. Well, it will be interesting to see if any of those certificates are signed——

Mr. **Sherick**. I think the Department is already getting them in signed.

Mr. **Sikorski**. And when the bills are——

Mr. **Sherick**. I asked that question, and they say people are signing them.

Mr. **Sikorski**. And you intend to—you hold those statements as accurate? And if there are criminal sanctions, if a criminal prosecution should be entailed, you intend to pursue that?

Mr. **Sherick**. Absolutely.

Mr. **Sikorski**. Very good. I thank you.

Mr. **Sherick**. I mean how are we going to make it work? We can't play pussycat forever.

Mr. **Wyden**. The gentleman from Kansas.

Mr. **Slattery**. Mr. Sherick, how long have you been in your present position?

Mr. **Sherick**. I have been the inspector general for 2 years next month.

Mr. **Slattery**. What I would like to do is focus, if we can, for a few minutes on what you see as your Department's priorities in this whole area because obviously we are becoming more and more aware of absolutely offensive overcharges, and what is happening, I fear, Mr. Sherick, is that we are going to see an unraveling of the political coalition in this country that is essential to the maintaining support for a strong national defense.

Mr. SHERICK. I agree with that.

Mr. SLATTERY [continuing]. As a result of what I consider to be some of the most obscene——

Mr. SHERICK. I agree. We are going to kill this opportunity to do what we have to do.

Mr. SLATTERY. What concerns me, Mr. Sherick, and I will be perfectly frank, is that you are the person over there in charge, are you not?

Mr. SHERICK. I'm not in charge of the Department of Defense; I'm the inspector general.

Mr. SLATTERY. You are in charge of this whole area of procurement and monitoring. You are the inspector general.

Mr. SHERICK. Yes; but I'm not in charge of procurement. I am in charge of oversight.

Mr. SLATTERY. Oversight of procurement, though; is that not correct?

Mr. SHERICK. Yes.

Mr. SLATTERY. Let's talk about your priorities. What are your priorities?

Mr. SHERICK. OK. Let me tell you what my priorities are, very quickly. The first priority I have is the quality of the goods that we are getting. I am concerned and my priorities on criminal investigations and audits are of shoddy material. In that, I mean there are creeps out there who are providing us material that is below standard, is below quality, and is junk.

We have prosecuted and convicted people over the last 2 years who have provided us, for instance, with faulty parachute shroud line that was crap. It was 25 years old. The guy dyed it with a mixture of paint and kerosene to make it look new, and provided that to us as parachute shroud line.

Mr. SLATTERY. Who are we talking about, Mr. Sherick? What company?

Mr. SHERICK. In Chicago.

Mr. SLATTERY. What is the name of the company?

Mr. SHERICK. The name of the company was American Cotton Yarns. The contractor and he went to jail.

These parachute shroud lines were used in parachutes, in cargo chutes, in rappelling lines for rangers, in all the webbing on aircraft carriers to keep people from falling off the side. That was the basic need that we had.

Mr. SLATTERY. How many dollars were involved?

Mr. SHERICK. It was provided over a period of years. In 1 year I think it was about $500,000 to $750,000.

Let me give you another example. Talk about the battleship *New Jersey*. We had a guy sell us substandard armor plate. It had about one-fourth the basic strength of the armor plate that we ordered. It was counterfeit. He had marked it to make it look like good armor, and it was installed on the *New Jersey*.

Mr. SLATTERY. What company are we talking about?

Mr. SHERICK. Specialty Metals. Now, the judge in that case—there were two people involved. Each one of them in that deal were going to make $750,000 a piece. He gave them each 10 years, and he said that they were not guilty of just fraud; they were guilty of sabotage. You know, that is what we need.

We had another contractor in Syracuse, NY who sold us arctic boots that leaked, and he knew they leaked. These were for our war reserve, for our Marines going into Norway. We have people that sell us chaff rockets that don't work. You know what happens. You have a group of airplanes going in against a radar site and they fire a chaff rocket, thinking it is going to blank out the radar. It doesn't work.

You know what they are going to do. They are going to get their butts shot off.

That is my number one priority, to go after that guy.

Mr. SLATTERY. Tell me what your procurement fraud priorities are.

Mr. SHERICK. Shoddy material, cost mischarging, defective pricing. Cost mischarging occurs when the project manager has 10 contracts that he is working on. Four of them are fixed price commercial contracts or fixed price Government contracts. The others are cost-plus Government contracts. He starts losing money on the fixed price contracts, so he tells everybody to put all the labor costs on the cost-plus Government contracts.

Mr. SLATTERY. Well, Mr. Sherick, we have seen instances now where General Dynamics has removed over $100 million in billings from the Department of Defense. What do you call that? Do you call that cost mischarging?

Mr. SHERICK. Absolutely.

Mr. SLATTERY. What do you think we should do with Mr. Lewis and that gang over at General Dynamics, and General Electric and all the others?

Mr. SHERICK. Well, let me say this. When we have a small company, the boss makes a decision: We are going to chisel. When you get into a big company, nobody like Mr. Lewis or others is going to sit there and say we are going to cheat. What they do is they say to that program manager: You better not lose any money on your commercial work. They don't say go cheat or anything else. They just say don't lose any money on that commercial work.

So what does he do?

Mr. SLATTERY. But you know, we have heard testimony that would tend to contradict what you are suggesting was the situation with General Dynamics. We have heard testimony that indicates——

Mr. SHERICK. Well, we could follow it to the top. That's great. Then the guy has to go to jail.

Mr. SLATTERY. If I recall correctly, it was the Chairman of the Board, Mr. Lewis, who was flying in his own aircraft on his way home, and he was in a conversation with one of the other officials in General Dynamics, talking about falsifying statements relating to the production schedules of the different submarines.

What has happened on that, Mr. Sherick?

Mr. SHERICK. I thought that was in the grand jury up in New York.

Mr. SLATTERY. Yes, I believe it is in Connecticut.

Mr. SHERICK. Is it in Connecticut?

Mr. SLATTERY. Yes. That is neither here nor there. But what is your office doing right now on that case to see that justice is done?

Mr. SHERICK. On that case I have one man who has been dedicated to work on that case working with the FBI, NIS, and the U.S. Attorney. We have been very supportive in providing auditors, et cetera.

Mr. SLATTERY. OK. This leads me to another point that I wanted to get at, too. You have been over there for several years, and during the last 2 or 3 years, we have seen the Defense budget in this country dramatically increased, and the amount of money we are spending for various weapons systems has spiraled.

Tell me, how many more people are you working with to monitor all this additional money that we are spending? Tell me what has happened with your shop over there. How many people do you have now? How many people did you have in 1980?

Mr. SHERICK. Well, 1980 was well before my time as Inspector General. There were about 300 auditors, in 1980, in the Office of the Secretary of Defense, Defense Audit Service.

Mr. SLATTERY. In the inspector general's office?

Mr. SHERICK. There wasn't an inspector general then. There was no inspector general until 1983. I am the first one. I took what was there and built the IG's office. I started out with about 300 auditors, and I now have over 1,100 total people. So we have tripled my overall force.

The Defense Contract Audit Agency, I think, has increased by about 600 auditors since that time, but again, you are going to have to ask Mr. Starrett.

Mr. SLATTERY. Do you feel you have adequate personnel right now to monitor the total procurement contracts?

Mr. SHERICK. No.

Mr. SLATTERY. Have you expressed this to Mr. Weinberger?

Mr. SHERICK. Yes, and I have authorization to hire more. As I told you, I'm trying to bring on another 500 auditors and 59 criminal investigators.

As I said earlier, one of the problems is getting good people and getting them to come to work for the Government, especially auditors. My auditors travel more than 50 percent of the time. With the kind of work they do, they are not met with bands playing when they arrive in a place to investigate, but they are all good people.

We have a turnover because of the travel.

Mr. SLATTERY. Well, let's go back, if we can, to the whole question of how we are utilizing our resources and the whole question of cost mischarging. How many DOD cost mischarging investigations have resulted in successful prosecutions since you became the inspector general?

Mr. SHERICK. I only know of one.

Mr. SLATTERY. Which one was that?

Mr. SHERICK. Well, there could have been more, but the only one that went to trial and prosecution was in Boston. The rest of them were all settled.

Mr. SLATTERY. What contractor was that, Mr. Sherick?

Mr. SHERICK. Systems architect.

Mr. SLATTERY. OK. How many are currently pending criminal prosecution? In other words, how many cases do you have where criminal charges have been filed?

Mr. SHERICK. We have 630 criminal investigations under way.

Mr. SLATTERY. You have 630 criminal investigations under way?

Mr. SHERICK. Right, and 427 of them are for contract fraud.

Mr. WYDEN. Would the gentleman yield?

Mr. SLATTERY. I would be happy.

Mr. WYDEN. What about Hughes?

Mr. SHERICK. I think Hughes is a Naval Investigative Service case.

Mr. WYDEN. Mr. Fitzgerald brought that to your attention.

Mr. SHERICK. That is the Tucson plant? We are working on Hughes, yes.

Mr. WYDEN. What is happening with respect to mischarging?

Mr. SHERICK. I don't know. It is under active investigation.

Mr. SLATTERY. What are your major cases? I mean are we talking about penny ante things or are we talking about major cases?

Mr. SHERICK. Well, as I told you, we have 36 or I have 36 cases that are against the top 100 DOD contractors.

Mr. SLATTERY. Those are criminal investigators?

Mr. SHERICK. You are an investigative committee, and I can certainly make available to your staff the whole list of the cases we have under way. We have to be very careful about rule 6[E] regarding grand jury information and others factors.

Mr. SLATTERY. Let me make sure I understand what you are saying.

Mr. WYDEN. Wait a minute. You will make that available to the committee?

Mr. SHERICK. Yes. We can give you a listing of the cases. One thing you have to understand, and I'm sure you do, is that you can compromise a case awfully easily by letting the material get out and into the hands of the wrong people. Some of our cases are undercover work. The contractors don't know about them and we have to be very careful.

We also have informants. We have people that could be badly injured if other people know about them. With those cautions, I don't have any problem with indicating to you what we have under way.

Mr. WYDEN. Just so we are clear, a listing of the cases and a summary of the cases.

Mr. SHERICK. We can give you a summary of what we are looking for.

[The following information was received:]

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON D C 20301

RECEIVED
JUN 14 1985
Subcommittee on
Oversight and Investigations
5:00 pm

Honorable John D. Dingell
Chairman, Subcommittee on
  Oversight and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Enclosed is a list of open Department of Defense investigations involving contractors identified on the top 100 Department of Defense contractor list. This list identifies 36 contractors and a total of 93 separate investigations. In addition, nine additional contractors from the top 100 list are under investigation on a total of 32 separate matters. Since these contractors are not yet aware of the pendency of the investigations, we are not including them on the enclosed list at this time.

As I indicated during my testimony on April 24, 1985 before your Subcommittee, this information is quite sensitive and may compromise the Government's investigations if released publicly at this time. Further, I do not believe the list should be publicly disclosed since some of the allegations upon which these investigations are based may prove that there is no wrongdoing on the part of the named contractor. In other cases, alternative civil, administrative or contractual remedies may be pursued if warranted by sufficient evidence.

My primary purpose in providing this list is to demonstrate that a substantial number of investigations have been initiated by the Department of Defense against our largest contractors. The opening of such investigations, while not conclusive of criminal wrongdoing on the part of the contractors, should illustrate that we have no reluctance within the Department of Defense to pursue allegations regardless of the size of the contractor involved.

Sincerely,

For Joseph H. Sherick
Inspector General

Enclosure

BEST COPY AVAILABLE

OPEN DOD INVESTIGATIONS INVOLVING TOP 100 DEFENSE CONTRACTORS AS OF MAY 1, 1985

CONTRACTOR	FRAUD OR OTHER ALLEGATION
McDonnell Douglas Corporation	Defective Pricing Cost Mischarging
Rockwell International Corporation	Cost and Labor Mischarging
General Dynamics Corporation	Cost Mischarging Subcontractor Kickbacks Labor Mischarging Product Substitution Security Compromise Defective Pricing Cost Duplication False Claims
Lockheed Corporation	Labor Mischarging
Boeing Company, Incorporated	Cost Mischarging Supply Accountability Labor Mischarging
General Electric Company	False Claims Defective Pricing Labor Cost Mischarging Product Substitution
United Technologies Corporation	Gratuities Subcontractor Kickbacks Cost Mischarging Bribery Defective Pricing

CONTRACTOR	FRAUD OR OTHER ALLEGATION
Raytheon Company	Labor Mischarging Product Substitution
Litton Industries, Incorporated	Bribery-Subcontractors Kickbacks Labor Mischarging False Claims Bid Rigging Cost Mischarging
Grumman Corporation	Cost Mischarging
Martin Marietta Corporation	Subcontractor Kickback Cost Mischarging
Westinghouse Electric Corporation	Cost Mischarging
Sperry Corporation	Labor Mischarging Cost Mischarging Defective Pricing
Honeywell, Incorporated	Diversion of Government Property Bid Rigging
Ford Motor Company	Defective Pricing-Labor Mischarging Falsification of Performance Records
Eaton Corporation	Conflict of Interest-Gratuities Cost Mischarging

CONTRACTOR	FRAUD OR OTHER ALLEGATION
TRW, Incorporated	Defective Pricing Cost Mischarging
Texas Instruments	Product Substitution
Northrop Corporation	Labor Mischarging False Progress Payments
AVCO Corporation	Subcontractor Kickbacks Cost Mischarging
Textron, Incorporated	Cost Mischarging
Allied Corporation	Conflict of Interest
Tenneco, Incorporated	Cost Mischarging
GTE Corporation	Unauthorized Acquisition and Utilization of Classified Data Labor Mischarging
Sanders Associates, Incorporated	Unauthorized Release of Contract Information
Motorola, Incorporated	Labor Mischarging
Congoleum Corporation	Mischarging Gratuities/Theft
Harris Corporation	Defective Pricing

CONTRACTOR	FRAUD OR OTHER ALLEGATION
Gould, Incorporated	Cost Mischarging
Emerson Electric Company	Cost Mischarging Gratuities-Cost Mischarging
Johns Hopkins University	Civilian Health and Medical Program of the Uniformed Services Fraud
TRACOR, Incorporated	Product Substitution
Lear Siegler, Incorporated	Product Substitution
Fairchild Industries, Incorporated	Gratuities Product Substitution Cost Mischarging False Statements
Dynalectron Corporation	Cost Mischarging
Todd Shipyard Corporation	Noncompliance with Contract

Mr. SHERICK. I hope that you will protect that kind of information. The last thing in the world I want to happen is for some crook to get off because I was blabbing.

Mr. SLATTERY. Sure, I understand.

Let me just sum up one thing you said. I want to make sure I understood it correctly. Are you suggesting, Mr. Sherick, that out of the top 100 Defense Department contractors, that currently 36 of them are——

Mr. SHERICK. Forty-five of them.

Mr. SLATTERY. Forty-five of them are subjects of criminal investigations?

Mr. SHERICK. Yes. Let me give you the statistics. In the Department of Defense, we have 131 open investigations relating to the top 100. Now, this is all the criminal investigations—not just mine; 71 are mine. And they involve 36 of the top 100. So we have 131 involving 45 of the contractors.

I have criminal investigations going against 23 of those 45.

Mr. SLATTERY. Say that again? You have what?

Mr. SHERICK. I have my agents working 23 of those. OSI has eight. NIS has eight. CID has six.

Mr. SLATTERY. OK.

The DIS investigated a Defense Logistics Agency employee in Richmond, VA, and this employee apparently bought dress shoes with the $50 allotment DLA provided him for safety shoes. This is an example, apparently, of the kind of investigation that DCIS has conducted. And DCIS investigated a white collar employee at DLA for selling two bushels of clams, and the employee allegedly was overheard at work taking an order for clams which is wife was selling, and he later allegedly delivered 2 bushels of clams on Government time.

I have a whole list of these kind of sort of petty investigations that DCIS has been involved in. I hope that, although these are important and I'm not trying to diminish the importance of these——

Mr. **Sherick.** I don't think they are.

Mr. **Slattery.** Well, I hope we are not chasing these people around that are selling 2 bushels of clams and overlooking $120 million operations by some of our major contractors.

Mr. **Sherick.** Right. You must understand that each of the military services have their own investigative service. In the Office of the Secretary of Defense, I am the investigator. DLA doesn't have any criminal investigators; I am it.

When they come to us with something like that, the first thing we try to do is fend them off. They say, hey, look, everybody in this installation knows that that guy stole that stuff or did that. If you let him get away with it, they will walk out of here with the building.

Mr. **Wyden.** Mr. Sherick, these are your investigators. These are DCIS investigators, and they are looking into five salami rolls missing from a DLA base cafeteria.

Mr. **Sherick.** The point is we are the DLA criminal investigator. We have just made an agreement within the last 6 months that the local industrial security people will handle that kind of case. We don't want to handle it, but there is no one else there. The commander thinks it is something that has a morale problem or something else.

I am not interested in that kind of case. We have agreed with the Director of DLA that he will handle that through his industrial security investigators. They have detectives that they have put on those cases. We don't want any part of that.

Mr. **Slattery.** I have no further questions now but I will have some more in a minute.

Mr. **Sherick.** Don't you guys eat lunch?

Mr. **Slattery.** We find that our witnesses oftentimes perform best when they are hungry.

Mr. **Sherick.** I'm not hungry. I knew I was going to be here, so I went to church this morning and I ate early.

Mr. **Slattery.** Did you get general absolution while you were there this morning?

Mr. **Sherick.** Yes, I did.

Mr. **Wyden.** Mr. Sherick, I want to ask you about a memo that I saw from Colin D. Parfitt to Mr. Ernest Fitzgerald dated April 5, 1985. The subject is "DOD IG Final Report on the Audits of Aircraft Engine Spare Parts Pricing, Costing Negotiation and DOD Review Functions."

Let me just read a little bit from this, and I am going to ask you what your reaction is. This memo says,

> Instead of pursuing their objective, the auditors looked at profits in the estimated cost bases from which the profits flowed. They support the fact that the estimates of costs were a trifle higher than they should have been; however, they did not delve into and analyze in detail the character and magnitude of the historical incurred costs upon which the contractor estimates were based.

> Thus, the auditors failed totally to address their fundamental objective of determining whether the prices for aircraft engine spare parts were fair and reasonable.

Then it goes on to say that the auditors questioned profits that weren't trivial, but then it goes on, and I am quoting here,

> Their amounts are piddlingly picayune in comparison with the billions of dollars that is squandered through gross inefficiency, as is shown by all the defense contractor efficiency data.
>
> The immensity of defense contractors' overhead in direct costs of all kinds literally begs for constructive analysis and evaluation. The auditor did none of this.

[The document referred to follows:]

OF THE ASSISTANT SECRETARY

5 April 1985

MEMO FOR MR. FITZGERALD

SUBJECT: DOD(IG) Final Report on the Audit of Aircraft Engine Spare Parts Pricing, Costing, Negotiation and DOD Review Functions (Project 3AP-087) (Report No. 85-081)

You suggested that I should prepare comments on the subject report.

The first paragraph of the report states that: "The objective of the audit was to determine whether fair and reasonable prices were obtained on procurements of aircraft engine spare parts..." The auditors evidently lost sight of their objective from the inception, it simply disappears.

Instead of pursuing their objective, the auditors looked at profits, and the estimated cost bases from which the profits flowed. They support the fact that the extimates of cost were a trifle higher than they should have been. However, they did not delve into and analyse in detail the character and magnitude of the "historical" incurred costs upon which the contractors' estimates were based. Thus, the auditors failed totally to address their fundamental objective of determining whether the prices of aircraft engine spare parts were fair and reasonable when evaluated in comparison with what they would be if produced with the usual cost control and ordinary efficiency of competitive free-enterprise production facilities.

The profits that the auditors questioned are not trivial in absolute terms, but their amounts are piddlingly picayune in comparison with the billions of dollars that are squandered through gross inefficiency, as is shown by all the defense contractor efficiency data that has been made available to us. Over and above that, the immensity of defense contractors' overhead/indirect costs of all kinds literally begs for constructive analysis and evaluation. The auditor did none of this.

In conclusion, I repeat that this audit was wholly nonproductive in terms of its initial objective.

Colin D. Parfitt
COLIN D. PARFITT

Mr. **WYDEN.** I want you to explain this to me. This seems to be Mr. Parfitt's evaluation of the DOD IG final report on the audit of aircraft engine spare parts pricing. Have you seen this memo?

Mr. **SHERICK.** No. I would like to have it. I would certainly like to look at it. If there is more out there, I want to go get it.

[The following information was received:]

Mr. Parfitt's comments should be answered in two parts—the objective of the audit and then the isssue of auditing the incurred costs for fairness and reasonableness.

Regarding the audit objectives, Mr. Parfitt correctly states the summarized objective of the audit,". . . whether fair and reasonable prices were obtained. . ." However, he omits the specific stated objectives which were to determine whether:

The contractors unjustifiably realized profits that were significantly greater than those negotiated with the Government.

The buying activities were using the support activities to help establish negotiation objectives.

The support activities were providing the buying activities with timely and adequate service.

Read as a whole, we clearly accomplished what we set out to do—and did it very well I hasten to add.

Regarding the second issue, I wholeheartedly concur with Mr. Parfitt that the issue of whether costs are fair and reasonable is also a significant one. The question of whether contractors are grossly inefficient, is a subject that needs much more attention than it is getting—from managers, DCAA audits and ultimately ourselves. Our emerging audit on the use of "should cost" as the most beneficial way to establish the Government's negotiation objective convinces me we can do better. I also believe that forcing more industrial engineering analysis of contractors' proposed direct labor and material, burden rates and manufacturing processes, and then pricing those results out in the DCAA reports, is the best way to attack this significant issue on an institutional basis. Postaward reviews, such as we did here would be tough to make stick because the cost would have been incurred and the contractor could make very compelling arguments that it was the right thing to do. A post audit would have a tough time coming up with data to support inefficiency (people sitting around doing nothing or large staff of overhead people not performing productive work) and if you could do it, you would have questionable basis for effecting price recovery. You have almost got to pick that up before it happens or through on-the scene audit coverage such as DCAA provides with its floor checks.

In summary, I agree that the kind of reviews Mr. Parfitt proposes are necessary. The question is how and when to do them.

Mr. **WYDEN.** We will get back to that because I think that certainly indicates that the situation that you seem to indicate with respect to spare parts isn't solved. Not only is it not solved, but that is a darned critical report that is freshly minted, April 5, 1985, and I am going to wait——

Mr. **SHERICK.** The audit report?

Mr. **WYDEN.** No, no. That analysis.

Mr. **SHERICK.** Well, I would like to have it.

Mr. **WYDEN.** I'm sure you would because it certainly is not consistent with what you said with respect to spare parts changes being made.

Mr. **SHERICK.** No, wait a minute. I never said the spare parts problem was settled. I'm going to conduct an audit to see if it is settled.

Mr. **WYDEN.** We will ask for your comment when we get it.

Let me ask you about one other area. I have been very concerned about overseas consultants, with defense contractors paying overseas consultants very substantial sums of money. For example, we have one instance, as you know, of an overseas consultant being paid $250,000 per year for 5 years, a total of $1.25 million.

Do you think that these kind of activities suggest that there are violations of the Foreign Corrupt Practices Act?

Mr. Sherick. Absolutely, yes. You don't hand a guy that kind of cash. I just get the idea that somebody is out there buying people, or buying contracts.

Mr. Wyden. Well, it is a good deal more than that in some instances. What are you doing about it?

Mr. Sherick. I have investigations involving foreign countries and consultants in foreign countries. I don't know if we have this one or not, but we certainly would be glad to look at it.

Mr. Wyden. Why didn't the DCAA tell you about this? This involves the IG.

Mr. Sherick. We do have that case.

Mr. Wyden. When did you get it?

Mr. Sherick. Is this in Korea?

Mr. Wyden. Yes. When did you get it?

Mr. Sherick. I don't know. A month ago.

Mr. Wyden. After our committee started looking at it.

Mr. Sherick. I can't answer that. You should ask DCAA.

Mr. Wyden. Did you get it from the DCAA or did you get it because this committee looked at it and it went into the public press?

Mr. Sherick. I don't know. I will give you that for the record.

[The following information was received:]

The Congressman is referring to the allegation that General Dynamics paid a retired Republic of Korea General a substantial bribe to obtain a $900 million F-16 contract under the Foreign Military Sales Program.

This allegation was reported directly to the Inspector General by the Secretary of Defense who had received the allegations in an anonymous letter March 11, 1985. This letter was referred to the Department of Justice on March 22, 1985 and arrangements were coordinated among the Department of Justice, the Securities and Exchange Commission and the Department of Defense to investigate the matter.

As result of meeting between the Office of the Inspector General, the Department of Justice and the Securities and Exchange Commission, the allegations regarding General Dynamics payment of bribes to foreign officials is being investigated exclusively by Securities and Exchange Commission with some minimal Defense Criminal Investigative Service support.

Mr. Wyden. Well, we will be very interested in that because I think that is yet another example. We have seen it throughout your testimony that you don't start looking at these things until this subcommittee looks at it and it gets into the public press.

Mr. Sherick. Well, I look at as much as I can and I look at a lot of things. If I said that I see everything in the Department of Defense, I would be lying.

Mr. Wyden. The point is that the DCAA should be reporting this to you.

Mr. Sherick. Absolutely. No question.

Mr. Wyden. And it is not going on.

Mr. Sherick. That is an instance where it has not gone on. You should ask DCAA about that.

Mr. Wyden. It is an instance where it is not going on, and you told us a few minutes ago that your relationship with the DCAA was essentially terrific.

Mr. Sherick. No. I was talking before about my access to DCAA records, where earlier they were not letting me look at what I wanted to look at. That relationship is much better. Even in terms of referral of fraud, the situation is better. I'm not saying that it's perfect. All I'm saying is, why they wouldn't give me that, I don't know. It doesn't sound reasonable that if they saw that, that they wouldn't provide it to me.

Mr. WYDEN. But this was in a published DCAA report, and you all didn't start on it until a month ago.

Mr. SHERICK. Yes.

Mr. WYDEN. You missed it.

Mr. SHERICK. I don't read all the DCAA reports. They put out 67,000 a year.

Mr. WYDEN. But this was an important one.

Mr. SHERICK. Well, as I say, they put out 67,000, and I don't read them all. The procedure is for them to report to us. As you said earlier, we are all Federal employees and they ought to report to us.

You know, as far as this is concerned, the cost estimating system of the contractors is something that I think deserves a lot of attention, and I don't feel it is getting it. I could lose every auditor I have in doing that type of audit. Without question. I could just soak them all up doing that. Yet we have 3,400 auditors in DCAA who are supposed to look at that.

Mr. WYDEN. So you think DCAA ought to do it.

Mr. SHERICK. Yes.

Mr. WYDEN. You think Mr. Parfitt is off base and really ripping into your auditor because he does; wouldn't you agree?

Mr. SHERICK. Sure he does. I guess he is frustrated. He has been trying to get the Air Force to do something for years, and they won't. He has been trying to get DCAA to do something. My problem is that I have the entire Department of Defense to worry about, not just one area that is already covered by somebody else.

Mr. WYDEN. But Mr. Parfitt is right, we have to look into the cost and not just the profits.

Mr. SHERICK. Yes, absolutely. I don't have any problem with that at all. But my audit was looking at something else. We were looking at pricing.

Mr. WYDEN. I am going to yield some more time to the gentleman from Kansas.

Mr. Sherick, I want to make two observations. We have been here a long time, and it would be hard for anybody who had been in here not to conclude that you are a decent man.

Mr. SHERICK. Thank you.

Mr. WYDEN. But I still think two things. One is that the David Lewises of the world have a disproportionate amount of influence over what is going on.

Mr. SHERICK. Absolutely.

Mr. WYDEN. And No. 2, this system almost breeds buck passing. What I think we are going to see later today and what we have seen all throughout these hearings is that everybody comes up and tell us what the problems are, and they say they are under demand and they have decent people who work hard, and they are all correct, but somebody else ought to look into it.

That is why I wanted to ask you about that memo from Mr. Parfitt, because I think you and I agree that there is a problem. Mr. Parfitt agrees that your auditor fell down, and you felt it ought to in DCAA. Somehow we have got to figure out a way to pull the pieces of this system together so we have an adequate deterrent.

What is most ironic about it is that we are still talking about cases where, based on what we heard yesterday, the taxpayer is going to be out some money. We know that. We haven't even tried to set up a preventive kind of system. I think we have got a lot of work to do.

Mr. **SHERICK.** Well, I appreciate what you are saying. I guess I get to be a pain in the butt, but my feeling is that we have got all kinds of systems. What we need in charge of the whole operation is some ass-kicker, if you will, who will really get out there and do the job. You are not going to bring somebody in from industry and you are not going to do it on an amateur night operation.

Somebody has got to go in there with the idea that they work for the taxpayers and they are not going to let anybody put any pressure on them: And that includes contractors, congressmen and anybody else. They are going to do what's right.

Mr. **WYDEN.** But it is not happening today.

Mr. **SHERICK.** Well, all I'm saying is you have to find whoever he is and get him in there.

Mr. **WYDEN.** But you are supposed to be that person.

Mr. **SHERICK.** No, I'm not. I don't run the system. I can say what is wrong. I can say what we have to do to fix it, but I can't say the magic words: "Do it." That is what we need, somebody who is willing to say: "Do it."

Mr. **WYDEN.** But you can bulldog these matters all the way to the very top.

Mr. **SHERICK.** Absolutely. And they are always building scaffolds for me, and that's OK.

Mr. **WYDEN.** I would be happy to yield to my friend from Kansas.

Mr. **SLATTERY.** You know, Mr. Sherick, you are making a very, very important statement, I think.

Mr. **SHERICK.** Absolutely. I know.

Mr. **SLATTERY.** I hope people are listening to what you are saying because what you are saying is that you need help from the top, and you know, the top is the President and the Secretary of Defense.

Mr. **SHERICK.** Yes. What I'm saying is good management comes from good managers, not auditors. In other words, if you don t do something about good management, that is running the place properly, all the auditors in the world won't correct it. They say to me, and they are right, you are the guy who comes down from the mountain after the battle and shoots the wounded. And I do.

It is easy for me. I sit there, and it's pathetic because what I do is catch them doing stuff that's wrong but already has happened. What you need is somebody in real time that will say we are not going to do that any more. We are changing the system. We are not going to back off. We are not going to let these people do this.

Mr. **SLATTERY.** Well, I guess I'm concerned, Mr. Sherick, because this is a pretty serious allegation you are making, in a way, and I, for the life of me, can't understand why "Cap the Knife" isn't over there acting like "Cap the Knife."

Mr. **SHERICK.** "Cap the Knife" is No. 1 in my book. I can't fault the man.

Mr. **Slattery**. Who is building the scaffolding that you just referred to?

Mr. **Sherick**. The procurement community, the contractors.

Mr. **Wyden**. But Mr. Weinberger has the authority to overrule those people.

Mr. **Sherick**. My neck isn't any longer than it was when I took the job. I haven't gone off one scaffold yet, and he is the guy who saves me.

Mr. **Slattery**. Then who in the world is building the scaffolding?

Mr. **Sherick**. The procurement community.

Mr. **Slattery**. OK. You know——

Mr. **Sherick**. They are not used to people like me looking at them. They are not used to people like me, and now they have got to get used to me. The Congress did that, and that's great.

Mr. **Wyden**. Mr. Sherick, you are saying that Secretary Weinberger has less influence than the procurement community?

Mr. **Sherick**. I would say that his entire attention is not necessarily on the niffs and naffs in the procurement community. He certainly wants to make changes. He directs changes, and it just takes a long time.

Mr. **Wyden**. We are talking about $100 billion. We have got to get his attention on this, don't we, the little niffs and naffs?

Mr. **Sherick**. I think we have got his attention now.

Mr. **Slattery**. You know, I am sitting here sort of thinking about what General Eisenhower, President Eisenhower, used to talk to us about when he referred to the military industrial complex and expressed concerns about what that meant to the freedoms of this country. What I hear you saying is that we have lost control.

I hear you saying, Mr. Sherick, and you are the inspector general of the Department of Defense, that when you complete your investigations, people over there are building scaffolding. I guess you mean they are making it more and more difficult for you to achieve your objectives.

You are saying it is not the Secretary of Defense, and you have said that it is the procurement community.

Mr. **Sherick**. They don't like to change.

Mr. **Slattery**. That is a serious charge, Mr. Sherick.

Mr. **Sherick**. Sure. They don't like to change. This has been going on for years. It went on when Ike was around. That's why he said, "Hey, watch it."

Mr. **Wyden**. What can we do so that the Secretary of Defense, in this case Mr. Weinberger, would have more influence on the procurement community?

Mr. **Sherick**. Give him a good man to run the procurement community.

Mr. **Wyden**. Who is this superstar?

Mr. **Sherick**. I don't know.

Mr. **Slattery**. One of the things that comes to mind, Mr. Sherick, you know, when you have lost control, as apparently we have in terms of how we are spending our money——

Mr. **Sherick**. I didn't say that; you did. I don't think we have. I think we have a lot of problems, but I don't think we have lost control.

Mr. **Slattery**. Well, that is probably a matter of definition, I suppose. But we do have serious problems, as evidenced by some of the things this committee has already uncovered and some of the testimony we have already heard. But one of the things I would observe—as I am right now due across Capitol Hill at the Budget Committee hearing—is that we ought to be doing something about the amount of money we are spending over there.

But I have some other questions. Recently the Washington Post ran several stories regarding the widespread criticism of the handling of the investigation of Admiral Metcalf's role in the Grenada gun episode, and I note that my colleague from the Armed Services Committee, Mr. Aspin, referred to the handling of this investigation as, and I use his term, creating a bad odor.

Are you satisfied, Mr. Sherick, with the way the Naval Investigative Service handled this investigation?

Mr. **Sherick**. The Naval Investigative Service was put out of it early on. I am completely dissatisfied with that, and I think that whole policy should be changed. I made a recommendation that it be changed, and as far as I understand the paper is on the Secretary of Defense's desk to change it.

Mr. **Slattery**. Who put them out?

Mr. **Sherick**. I think it was Admiral McDonald who was commander of the Atlantic Fleet.

Mr. **Slattery**. And Admiral McDonald then is Admiral Metcalf's immediate supervisor?

Mr. **Sherick**. Yes. By the way, I am doing an investigation of that. It should be completed very shortly.

Mr. **Wyden**. Would you supply that for the record?

Mr. **Sherick**. As soon as it's finished, yes. I would rather not get involved in who struck John on it right now, because it is a continuing investigation.

But to answer your question, no, I was not happy that the Naval Investigative Service could be turned off. I objected to it.

Mr. **Slattery**. Don't we have a structure over there where Admiral Metcalf's superior office can, in effect, call the investigation off?

Mr. **Sherick**. Yes; and it is being changed, I hope.

Mr. **Slattery**. Is it possible, Mr. Sherick, to expect the NIS or the Army Investigative Service to inspect some of the highest ranking people within their respective branches?

Mr. **Sherick**. It depends on who wants them inspected, who wants them investigated. I have taken cases from them because I think they can't do it.

Mr. **Slattery**. Well, as a practical matter, what you have is probably low ranking officers and enlisted——

Mr. **Sherick**. No; the agents are civilians. The Naval Investigative Service is all civilian.

Mr. **Slattery**. The NIS is entirely a civilian operation?

Mr. **Sherick**. It has some military officers who are chiefs, but they are not criminal investigators.

Mr. **Slattery**. So we have those military officers inspecting an admiral, in effect?

Mr. **Sherick**. Yeah, you could say that.

Mr. **Slattery**. A tough row to hoe, I would say.

Mr. **Sherick**. It depends. I have got investigators. They would investigate the President; it wouldn't bother them.

Mr. **Wyden**. If the gentleman would yield very briefly. What about Admiral Thurman? Now, he is a three-star admiral who is being investigated.

Mr. **Sherick**. I thought that was the dog.

Mr. **Wyden**. No; Admiral Thurman.

Mr. **Sherick**. No; I don't know him.

Mr. **Wyden**. He is a three-star admiral being investigated by the NIS.

Mr. **Sherick**. I don't know any reason. The Naval Investigative Service reports to the Vice Chief of Navy Operations who is a four-star.

Mr. **Wyden**. What are the chances that that would be shut down, similar to the Metcalf situation?

Mr. **Sherick**. I don't think it will be shut down. I just don't think it will. If it is shut down, I'll open it up.

Mr. **Slattery**. Mr. Sherick, in 1983 the GAO made a recommendation that these different investigative agencies within the different branches of the Service be able to initiate investigations without seeking command approval first.

Now, what's the status of that recommendation?

Mr. **Sherick**. I agreed with that. The Secretary of Defense made a decision that the Military Services could continue that practice—there were only two, the Air Force and the Navy. Nobody can shut the Army down. They had to report every instance where that happened up through the system to me. That was the resolution.

As a result of the Metcalf incident he is changing that policy where they can't shut anything down.

Mr. **Slattery**. Who's doing it?

Mr. **Sherick**. The Secretary of Defense.

Mr. **Slattery**. The Secretary of Defense is changing that policy so that in the future, NIS will be able to proceed with these kinds of investigations?

Mr. **Sherick**. Not just NIS. OSI as well.

Mr. **Slattery**. And all the rest?

Mr. **Sherick**. Well, CID, as I said, never had that problem.

Mr. **Slattery**. One of the things I'm having difficulty sort of getting a grasp on is who within the DOD is really responsible for signing off, you might say, on different procurement contracts? What person is responsible for saying, in effect, we're going to pay the bills whether it's dog care or babysitting services or outlandish parties or whatever it may be. And how are we dealing with those people that are supposed to be protecting the taxpayers' dollars within DOD? And what should we be doing with those people in the future who are obviously acting irresponsibly? What do you recommend, Mr. Sherick? What are you and Secretary Weinberger doing right now to deal with this problem?

We can point the finger at the business community and the procurement community, as you have referred to, all we want to. But it seems to me, if we're going to really address this problem, we're going to have to do it within the Pentagon, within our side of the contract, so to speak. When I say our side, I mean on the taxpayers' side.

What are we doing right now to correct that problem within the DOD? What is the Secretary of Defense doing; what are you doing, Mr. Sherick, to address this problem?

Mr. SHERICK. Well, the Secretary of Defense has a whole series of initiatives that are directed at tightening up the whole procurement process.

Mr. SLATTERY. Would you elaborate on that specifically for us? Has he announced these?

Mr. SHERICK. Yes; more competition.

Mr. SLATTERY. We have heard that, Mr. Sherick, since the Truman Commission.

Mr. SHERICK. But that is the answer. It's not easy, but that's the answer. More competition.

Mr. SLATTERY. You know, the reality is, Mr. Sherick, that a lot of studies have indicated that less than 5 percent of the procurement that we contract for, weapons procurement, is really under competitive bid.

Mr. SHERICK. No; I don't think that's right.

Mr. SLATTERY. Well, some of the studies have indicated that.

Mr. SHERICK. Well, the contracts are just fixed-price. We go out and we buy 22 desks and that kind of product. There are millions of those.

The negotiated contracts, the big dollar contracts are the ones that are negotiated, they are not competitive. What we get involved in, Mr. Slattery, is something like this. I'm just saying this is the way it is; I'm not defending it. We go out for a new fighter airplane and get McDonnell-Douglas, General Dynamics, Boeing, Grumman, we get all these people competing. They are all competing for that contract.

You finally decide that you're going to buy the F-18. That's the one that meets all your requirements. It's got the best price, the best schedule, everything else.

You are now going to buy 3,200 of those from McDonnell-Douglas, and you have already agreed to a price because you have competed the whole thing.

You don't buy them all at once. Congress doesn't let us go out and buy 3,200 airplanes. They say to us, you can buy so many a year. Now, each year we have to go back to that contractor because we have facilitized him. He's got the facilities, he's got everything; he's got the know-how. He's the guy who designed the airplane.

Now, you may say going back each year is not competition, but the competition was on the front end. Now, you can go out each year and compete, but nobody could ever get near him because he knows how to do it. That's one of the things that you have to understand in defense acquisitions.

Mr. SLATTERY. OK. So you've talked about competition. What else? What are we going to do internally in the Department of Defense so that a year from now or 2 years from now, if we ever have another situation——

Mr. SHERICK. Well, I mentioned some things earlier. I think we've got to put some more money in training.

Mr. SLATTERY. Training of personnel in the DOD?

Mr. **SHERICK**. Sure. As I told you, my audit determined that 67 percent of the procurement people were not trained at the level that was required for them to hold their jobs.

Mr. **SLATTERY**. Sixty-seven percent were not adequately trained?

Mr. **SHERICK**. Yeah; 67 percent. We are not adequately training them. We've got a turnover in the civil service, but you've got to invest money in training. You've got to hold people accountable.

Mr. **SLATTERY**. How do you do that, Mr. Sherick? That's really what I'm talking about.

Mr. **SHERICK**. You write up their job sheets and evaluate them.

Mr. **SLATTERY**. Are we doing that now, Mr. Sherick?

Mr. **SHERICK**. Yes. We are attempting to do it.

Mr. **SLATTERY**. Have we been doing it, Mr. Sherick?

Mr. **SHERICK**. Since the Civil Service Reform Act of 1978, they have been developing that system and they are doing it. We're asking that more and more critical elements be put in that are the kind of things that you measure someone on and say, you're not doing it. And you've got to refine that.

But when you say that to an employee, the employee says, "Look, you've got to give me the training that's necessary for me to live up to that critical element."

Mr. **SLATTERY**. Well, what kind of training, though, Mr. Sherick, is required? I mean, we've sat on this committee and I'm not an accountant, but I can sit in this committee and look over a voucher submitted to Department of Defense for reimbursement that looked like a statement from your MasterCharge card. It doesn't take a genius to look down and read those billings, those vouchers that are submitted, and clearly see what in the world you're paying for.

Mr. **SHERICK**. That's right, and some clerk does that. The only thing that clerk is looking for is what was already agreed to.

The thing that's important is what was agreed to on the front end. How do you administer that contract, how do you handle the contract, how do you know what's going on in that contract. Those are the things that are important.

We have a voucher here and you can say, look at the price on that item. We don't know if that material was really needed on that contract, or if it was ever issued.

Mr. **SLATTERY**. Well, wait a minute, I'm talking about things like dog care, and I'm talking about things like dozens and dozens of golf balls being bought, and I'm talking about things like——

Mr. **SHERICK**. I couldn't argue with that.

Mr. **SLATTERY**. You know, travel to and from someone's home, and not $100 but thousands of dollars. Someone, it seems to me, has to look over that stuff and say yes or no to it. And what I would like to know, Mr. Sherick, is what kind of a system do you have in place in your shop, and do we have in place in DOD, to deal with that. So when somebody screws up over there somebody is held accountable.

Do we fire people for it, or do we say, "Hey, captain, you sort of messed up; can you keep a closer eye on this?" after you've let a half a million dollars slide through your fingers here, or a half a billion dollars? I don't know how much. What kind of a system do we have in place today in the DOD to hold those kind of people accountable?

Mr. **Sherick**. I'm sure they have. The contracting officers can go to jail

Mr. **Slattery**. When did the last one go to jail? You can answer that question. You say we send those people to jail. When was the last time we sent someone to jail from the DOD?

Mr. **Sherick**. I don't know, but we can find out. It has to be a crime.

Mr. **Slattery**. I would like that information for the record.

[The following information was received:]

An ongoing series of investigations at the Defense Industrial Supply Center (DISC), Philadelphia, PA, has resulted in a number of Department of Defense personnel being convicted in connection with contract fraud. As a result of these cases, during the last one and one-half years, seven DISC employees have been convicted of crimes including gratuities, bribery, conspiracy and perjury. Sentences of these employees ranged from fines of $1,000-$2,000 and probation up to fines of $30,000 and four years in jail with five years probation.

In another recent contract fraud case involving Alamo Aircraft Supply, Incorporated, approximately 26 Air Force employees were disciplined for their actions even though they had not been convicted of any crimes. The disciplinary actions ranged from letters of reprimand to removal in the most serious instances.

Mr. **Sherick**. Being dumb is not a crime. You fire them for being dumb.

Mr. **Slattery**. Well, for the record, let us know who was the last person to be either demoted, fired, disciplined for being either incompetent or being so negligent as to almost be criminal. OK?

[The following information was received:]

On April 2, 1984, the Merit Systems Protection Board (MSPB) issued a final order upholding the demotion of an Army employee. The person was demoted for filing a false certification with respect to an Army contract.

The Army wanted the person fired, but was overruled by the MSPB. The person had a 25 year unblemished career with the Government and the false certification did not result in any loss to the Government. The certification had been used to obtain supplies for the Government under a contract when the contract did not allow purchases of such supplies.

The person was demoted to the next lower grade in a non-supervisory capacity. It was the opinion of the MSPB that the fact that the Government lost nothing, that the person gained nothing, and that the person had a 25 year unblemished career record mitigated against the punishment of dismissal.

In a criminal proceeding the person was convicted of one count of defrauding the Government.

Mr. **Slattery**. I want to know what system we have in place.

Mr. **Sherick**. All right. We have 3,400 contract auditors and DCAA is going to talk to you about that. They are the people responsible for doing just what you say, for checking what's happening in those contractor plants. There are 3,400 of them all around the country, and that is their mission. That's a very expensive organization, a very large group of people.

Mr. **Slattery**. Well, then, you know, I've only been involved in this for about 2 months, Mr. Sherick, but I can tell you that within the last 2 months, I have seen very little evidence to really give me a lot of confidence in what these 3,400 folks are doing.

Now, do you think we're doing an adequate job in this area right now?

Mr. **Sherick**. I would have to say no.

Mr. **Slattery**. OK. And do you think the 100 more people that you've requested is going to enable you——

Mr. **Sherick**. You're talking about DCAA. In terms of numbers of people, I think DCAA has nearly the number of people it needs. My biggest complaint with DCAA is basically that they do too much proposal auditing and not enough incurred cost auditing.

Mr. **Slattery**. Say that again?

Mr **Sherick**. In a proposal audit, we review a contractor's proposal on how much he will charge us. This is done before there is a contract. An incurred cost audit is done after there's a contract, and everything you're talking about here is incurred costs.

My problem with DCAA is that I think that they spend too much time on the proposal end of it and not enough time on the incurred costs.

Mr. **Slattery**. I would still like to get back if we can, so that I have a clear understanding of what authority we have right now to penalize, to discipline or however you want to say it——

Mr. **Sherick**. We have all the authority in the world. We have a set of administrative penalties that if we find people doing something wrong, we can fire them.

Mr. **Slattery**. Are most of these people civilian people or are they military?

Mr. **Sherick**. Yeah, but even the military system provides for court martial. I don't think you need any special rule. It's like everything else; it's enforcing.

Mr. **Slattery**. OK. You think that existing authority and regulation, the existing law, is adequate to really deal with these situations? Is that what you're saying?

Mr. **Sherick**. Yes.

Mr. **Slattery**. So you think it's a question of enforcement?

Mr. **Sherick**. Yes. If you think you're going to come up with some simple bill that's going to do it all, you are wrong. I think the idea is enforcing what we have. Making people do it.

Mr. **Slattery**. Earlier today Mr. Conahan indicated that he felt like we should, in fact, enact some legislation to clarify that certain things would no longer be permissible as overhead charges to DOD; specifically, things like entertainment costs and——

Mr. **Sherick**. That is the cost accounting standards. The problem with the cost accounting standards that Mr. Conahan didn't explain to you is there was a Cost Accounting Standards Board that established those standards. It was disestablished by the Congress about 3 or 4 years ago. Now they have no way of amending them to make them more precise.

I have recommended that the Cost Accounting Standards Board be reinstituted. The Comptroller General was in charge of it, and there were representatives from around the Government. I think that that board ought to reconstituted.

Mr. **Slattery**. When was it eliminated?

Mr. **Sherick**. In 1980.

Mr. **Slattery**. And you believe it should be reinstituted?

Mr. **Sherick**. Absolutely.

Mr. **Slattery**. Well, what I hear you saying is sort of, get out of your way and let you do the job. And you know, you're telling us that you have the authority over there to do the job currently, and it's a question of enforcement. And I assume that the Secretary of

Defense and the Joint Chiefs have the authority they need to enforce the regulations.

Mr. SHERICK. They certainly do.

Mr. SLATTERY. And I assume they have had this authority for some time, have they not, Mr. Sherick?

Mr. SHERICK. Yes.

Mr. SLATTERY. So really what you're telling us, Mr. Sherick, is that we have a problem with the enforcement within the Department of Defense. We have not been as tough as we should be.

Mr. SLATTERY. As tough as we should have been over the last few years in this whole area. That's what you're saying, Mr. Sherick?

Mr. SHERICK. Absolutely.

Mr. SLATTERY. I think that's a pretty serious statement, if you want to know the truth. I mean, you know, we have almost doubled our defense budget in the last few years and it seems like we have a sieve over there for taxpayers' dollars.

Mr. SHERICK. I can't agree with you on that. I don't think there's a sieve.

Mr. SLATTERY. Well, you just did.

Mr. SHERICK. No. That's saying that everything is pervasive. I think there's no question that there are problems there and they have to be corrected. The Department of Defense—I look at the whole Department of Defense—does a hell of a lot of things right. They do many, many things right. This has been going on for years.

The Department of Defense does 90 percent of what it does right, and it carries on its back this monkey called the acquisition process. It keeps getting beaten over the head for weaknesses and problems in that. Someday soon, it has to solve that problem. Believe me, this country has a fine Department of Defense with many, many fine people in it doing a mission all over the world, and doing it very well.

I don't believe that it should be pilloried or anything else. If they want to talk about the acquisition problems that's fine. But, the Department of Defense is made up of a hell of a lot good people doing a good job every day. This country has to be proud of them because they are doing a good job, and they want to do a good job. They are very motivated and dedicated people.

Mr. SLATTERY. Mr. Sherick, I want you to know that I happen to agree with that, and one of the reasons that I'm very interested in this whole question of procurement overcharges and mischarges, cost overruns and the whole thing is because I honestly believe that if it is not corrected and corrected very quickly, and if some people that are responsible for a lot of this just gross conduct both in and outside of the Defense establishment are not brought to justice, we are going to have a serious problem in this country maintaining the political consensus that we need to continue the commitment to a strong national defense. That's what I'm concerned about.

Mr. SHERICK. Mr. Slattery, you're absolutely right and I agree with you 100 percent. What worries me is that we are going to let these kind of weaknesses ruin our ability to put our country in a position of strength to the degree that we have to have it. That's what I think is important.

Mr. **Slattery**. Mr. Sherick, I'm going to have to go to the Budget Committee now, but I want you to know that I personally believe that you have an historic responsibility. You're in a very, very important position. Your position in terms of importance over there, at this point in time, may be second only to perhaps Mr. Weinberger's responsibility because of the problems we have had.

I wish you well.

Mr. **Sherick**. And for all of that, I make about $6,000 a year.

Mr. **Slattery**. Overpaid and underworked, huh? I say that facetiously.

Mr. **Sherick**. No; I could retire tomorrow. I've got more than enough years, and I compute that I make about $6,000 a year.

Mr. **Sikorski**. General Dynamics might be looking for a new chairman.

Mr. **Sherick**. Oh, they don't want me. They wouldn't touch me with a 10-foot pole. Maybe that's what they need.

Mr. **Slattery**. You know, I find it really interesting that we currently have about 45, I guess, criminal investigations involving the top 100 DOD contractors.

OK. I yield back any time that I might have remaining, Mr. Chairman.

Mr. **Wyden**. The Chair thanks the gentleman from Kansas. Just a couple of other questions and then we want to give some time to the gentleman from Florida, Mr. Bilirakis.

Mr. Sherick, on September 25, 1984 you issued a news release, and I have commented on these and they concern me greatly. This September 25, 1984 news release summarized prosecutive action against eight individuals in four companies who are suspected or convicted of defrauding the Department of Defense.

What concerns me is that this is really an example of delaying the release of information. One of the actions you announced on that date occurred almost a month previously, and in another case it occurred almost two months before. And I just find it somewhat strange that these outdated announcements were released on September 25. I think it is strange because on the very next day, September 26, you and Mr. Burch, Assistant Secretary of Defense for Public Affairs, held a lengthy news briefing at the Pentagon, detailing the progress that you had made in the previous 3 years.

Now, why are you holding up the releases? Does it have anything to do with the election, Mr. Sherick?

Mr. **Sherick**. No. It didn't have a thing to do with the election.

Mr. **Wyden**. We have had very good sources who have indicated otherwise.

Mr. **Sherick**. Well, that's fine. The GAO looked into that, and I think they gave me a clean bill of health. I didn't have any interest in the election. What I am interested in is being the inspector general, and getting the word out. This case involved the battleship *New Jersey*.

Mr. **Wyden**. Why didn't you get the word out on the day it happened?

Mr. **Sherick**. Well, first of all, the date of conviction comes down and the judge usually holds a hearing and looks for sentencing information. We have to get the word up through the system to us. I don't know why it took that long. I would prefer that we put out a press release the same day.

We also may have agreements with the U.S. Attorney and the FBI, if they are all involved, that we will all put them out together.

Mr. **Wyden**. Why did the GAO look into this situation?

Mr. **Sherick**. Because Senator Nunn asked them to.

Mr. **Wyden**. Why was that?

Mr. **Sherick**. For the same reason that you just asked the question; was my press conference related to the election.

Mr. **Wyden**. And you say today it had absolutely no relation to the election?

Mr. **Sherick**. No. The reason I had the press conference was that we were trying to get the word out that we've got an inspector general and we're after people.

I have a lot of press conferences. I meet every reporter that will come to me. I'll talk to him because I think it's very important that they understand and that they know and they pass the word about what I'm trying to do.

Mr. **Wyden**. I had a question also about how these news releases are communicated to the media. You said that people call you and you talk to them, but how do you handle it otherwise? We were told that something was placed in a rack at the Pentagon?

Mr. **Sherick**. Yes. A reporter can go over there any day in that press room, there are "blue tops" that are issued every day with information. That's part of the information system. Almost every major newspaper, wire service, or media organization has people stationed right at the Pentagon.

Mr. **Wyden**. Wouldn't it be smarter to issue the press releases in the region where the firm is located rather than in Washington?

Mr. **Sherick**. We give them to the wire services, and the wire services move them everywhere. We try to release them locally, too. Usually the U.S. Attorney does that. We find that we get them to the wire services and they give them extensive circulation. There are a lot of other associations such as the newspaper chains that have Pentagon correspondents that pick them up.

Mr. **Wyden**. I still can't understand why we are waiting all that time. Again, it doesn't strike me as part of the most vigorous effort to get this information out to the public and get the value of the——

Mr. **Sherick**. Well, I get it out as fast as I get it. There is no reason for me to hold up any of that information.

Mr. **Wyden**. But you didn't in the case that we talked about on September 25, 1984.

Mr. **Sherick**. Well, I don't know when I got it. I would have to go back and find out when did we get these data and how they moved up through the system. I will be glad to do that for you.

[The following information was received:]

The information in the September 25, 1984 Department of Defense press release contains highlights of seven judicial actions (sentencing, indictment, pleas) taken subsequent to six Defense Criminal Investigative Service and one Federal Bureau of Investigation/Naval Investigative Service investigation. The judicial actions occurred from July 19, 1984, through September 14, 1984.

The purpose of the press release was to generally summarize recent antifraud initiatives and accomplishments within the Department of Defense.

Mr. WYDEN. I will ask you only one other question. In the previous round of questions, you said in response to me that essentially Secretary Weinberger had less influence than the procurement community, that he was essentially subordinate to the procurement community.

Mr. SHERICK. No, he isn't. I didn't say that. I said that his influence is not as strong in the procurement community as I would want it.

Mr. WYDEN. Who is the person, then, if it is not Secretary Weinberger? You said we had to have all kinds of people—I'm not going to even use the language that you used—but where is this superstar? Who is it going to be who is going to turn around these procurement practices?

Mr. SHERICK. I don't know.

Mr. WYDEN. Who is doing it now? It is not being done now, is it?

Mr. SHERICK. There is a lot going on to turn it around, let me say that, and there are a lot of good people who have been recently appointed, for instance, to the Army Materiel Command.

Mr. WYDEN. But that is just spreading the responsibility all over the government. The buck has to stop somewhere.

Mr. SHERICK. Yes, and there is a job open over there. It's called Acquisition and Logistics. I am sure they are looking for a good man. There is also the Undersecretary of Defense for Research and Engineering.

Mr. WYDEN. Well, Chairman Dingell is very busy with his duties here, and I saw Mr. Fitzgerald raise his hand in the audience, so I think there are some good people available, but I just think that it is incredible to have a situation where on several occasions you told us that basically the procurement community had more influence than Secretary Weinberger and that the buck——

Mr. SHERICK. You keep saying that. I don't think I said it.

Mr. WYDEN. Tell me, then. Who is going to be the one who turns around these procurement practices? You said that somebody in the Air Force is doing it, somebody somewhere else is doing it.

Mr. SHERICK. You have to understand: Harry Truman said, Ike will come in here and say "Do it," and nothing will happen, and that is the way it is with the President. That's the way it is when you are in a big bureaucracy.

The first thing you have to do is get the attention of the people out there. You have to let them know that you mean business. You have to let them know what your priorities are. And when you do that, you get things done, and that is the important thing. You just have to keep pounding away and pounding away because what you are doing is you are making them change the way they do business. They don't like to do that. That's the way it is in any big organization. It's just a continuous process of saying: By God, that's what I'm going to do.

That is why the Secretary of Defense keeps putting out letters and directives telling people that these are our policies; and it is turning around. You have 2 million military and a million civilians out there, and you have to turn them around, and that's a big job.

Mr. WYDEN. I would only tell you that at this pace, we are going to see millions and millions of dollars of the taxpayers' money wasted before it is turned around, and I think that what I said earlier reflects my point of view, having listened to you for a substantial amount of time. Anybody who listens to you would say you are a decent man but clearly the David Lewises have a disproportionate amount of influence on the system, and there is nobody in government who is powerful or in a position to stop it.

The gentleman from Florida.

Mr. **BILIRAKIS**. Thank you, Mr. Chairman.

I just wish I had been here earlier, Mr. Sherick, to have heard all of your testimony, and I apologize to you and the panel for not having been here.

Why would General Dynamics not touch you with a ten foot pole, Mr. Sherick?

Mr. **SHERICK**. Because I have not been friendly to contractors, I don't think they like me.

Mr. **BILIRAKIS**. Why is that? Do you feel that your job is structured so that you not be friendly to contractors?

Mr. **SHERICK**. No, that's just the way I feel. What I am saying here is that, if I wasn't the IG tomorrow, I would still feel the same way. I believe that the U.S. Government deserves—I want the contractors to treat us like a good customer, not like a partner.

I read the other day in the Wall Street Journal that partners normally hate each other. When you talk to the contractors, they say, well, we are partners; and now I understand why.

I want them to treat us like a good customer, and I want us to treat them like a good supplier. I want them to make a fair profit. I want them to do good work because I think that our mission in the Department of Defense is so important that we must get good work from contractors. I think they deserve a fair profit. If we don't give them a fair profit, they are not going to do good work, and I think it is important that that all happen.

But the bottom line is that I think our mission is so important. This is not a friendly world, and we just cannot afford to waste any money or any time playing around with this kind of poppycock. We can't do that. We have to make our contractors understand they have to be sensitive.

As the gentleman said, there is a possibility, that because of these practices that we could lose the support of the American people, which would be a tragedy.

Mr. **BILIRAKIS**. Believe me, sir, and I speak as a person who has strongly supported the security of this Nation——

Mr. **SHERICK**. Yes. I've got seven children, and this is their world.

Mr. **BILIRAKIS**. Well, it's not a possibility; it's happening.

Mr. **SHERICK**. I feel bad about that and I don't think it should happen.

Mr. **BILIRAKIS**. All right. Are you telling us that there aren't enough people like you in the higher echelons of Government, DCAA and procurement, et cetera, et cetera, and that is where our problems lie?

Mr. **SHERICK**. I will tell you, you get tired awfully fast in this business. There are a lot of dedicated people. You say DCAA. I think there are a hell of a lot of good, dedicated people in DCAA.

Mr. **BILIRAKIS**. All right. But are there enough? I mean really, where do the problems lie, sir? No reflection on any of my colleagues. If the shoe fits in some cases, wear it, I suppose. But quite often these hearings turn out to be nothing but soapboxes, and there really isn't much of a bottom line in terms of accomplishment.

I sometimes wonder if Congress wouldn't really prefer that problems like this continue to exist because it gives us something to do and gives us the opportunity to lash out at the other side, or whatever the case may be. Somehow we have got to solve these problems, and I think that much of it goes to the mind of the individual, what is inside and their philosophy and that sort of thing.

I think an awful lot of it goes to changing the picture. Were you in the audience yesterday, sir?

Mr. **Sherick**. No, I was not.

Mr. **Bilirakis**. Did you read the newspapers today regarding Mr. Spanton's recommendations?

Mr. **Sherick**. Yes, and I agree with all of them.

Mr. **Bilirakis**. You do. Do you see any reason why you cannot——

Mr. **Sherick**. There are a couple there, but most of what he has to say I don't have a problem with.

Mr. **Bilirakis**. Well, how about the portion that has to do with the separation of audit operations and procurement operations from the Defense Department Comptroller?

Mr. **Sherick**. Well, the Defense Department Comptroller doesn't have any procurement operation responsibility at all. He is strictly the financial officer of the Department.

Mr. **Bilirakis**. All right, but Mr. Spanton testified that when he was a Navy auditor, he had the authority to reject claims, black and white. As a DCAA person now, he does not have that authority; he just merely makes recommendations.

Mr. **Sherick**. Yes.

Mr. **Bilirakis**. And those recommendations are acted upon by the procurement people. We do not have the proper check and balance there, do we?

Mr. **Sherick**. That is right.

Mr. **Bilirakis**. So you do agree there should be some changes made?

Mr. **Sherick**. Absolutely. I think the auditors ought to be able to say no.

Mr. **Bilirakis**. Do you see any reason why, if these improvements are not advancing fast enough—and I might add to some of the things you have said that I have worked in the aerospace industry for many years as an engineer and as an attorney.

Do you believe that we can change the overall picture in terms of proper checks and balances? Must there be a position created, an overall position created with the full responsibility to take a look at the overall picture and to make recommendations, to make some changes in the procurement regulations and the acquisition regulations and the audit regulations?

You know, there was also testimony yesterday, and I think you would bear this out, that the particular DCAA auditor may take a look at a claim and render a particular opinion on it, and a different auditor would render a completely different opinion. And this is aside from what is in the contract. I would assume that we have got to be consistent with what is in the contract and there must be proper contracting.

I'm glad to hear you say that a lot of contracts are fixed price contracts because in my experience in industry many years ago, for the most part they were CPIF. But do you feel that possibly maybe a czar position, if you will, should be created strictly with this in mind, to make recommendations as far as changes of the overall picture, someone who would not be a part of the DOD, would not be a part of the DCAA or the military?

Mr. SHERICK. There was a procurement commission the Congress ran within the last 10 years, and they came up with all kinds of recommendations. Congress established, within OMB, an Office of Federal Procurement, and it exists today. They are the ones that put out the Federal acquistion regulations.

So there is that kind of Czar, and it is not in the Department of Defense; it is in the Executive Office of the President.

Mr. BILIRAKIS. But they are part of the administration.

Mr. SHERICK. Yes; but it came about as the result of a congressional commission. So I don't know what that would do. I think this morning Frank Conahan, and I agreed with him, testified on the vagueness of some of the regulations and that they should be more precise. I agreed that the Cost Accounting Standards Board should be recreated to be able to keep those things viable and usable.

I think that kind of action should be taken. When you go out into contractors' plants, there are a lot of good people out there, and they are really dedicated and they want to do a good job. To tar them with a brush that says everybody in the defense industry is a crook isn't fair. They have their share of bad people; we have our share. We do dumb things. They do dumb things.

Mr. BILIRAKIS. But they are all being reflected upon as a result of some of this.

Mr. SHERICK. It is a cultural change we are going to have to impose on the procurement system. We are going to have to say to people that we mean business.

Mr. BILIRAKIS. Sir, you became inspector general on May 20, 1983. The Office of Defense inspector general was established September 1982. Did you have a predecessor in that office?

Mr. SHERICK. No.

Mr. BILIRAKIS. It was just vacant during that period of time?

Mr. SHERICK. Yes. I was nominated early on by the Secretary of Defense, and there was a jurisdictional problem for a while on what committee would handle my confirmation. It ended up they were arguing between Governmental Affairs Committee and the Armed Services Committee because the inspector general was created in the Defense authorization bill.

Finally it went to the Parliamentarian, and he ruled that I had to appear before both committees to be confirmed. So I had to go to each committee and go through their paperwork and their hearing before I was confirmed.

Mr. BILIRAKIS. All right. Now, you were Assistant to the Secretary of Defense for Review and Oversight prior to that?

Mr. SHERICK. That's right.

Mr. BILIRAKIS. Was basically your job, then, the inspector general's job without having that title?

Mr. SHERICK. Yes; but I didn't have statutory authority and I didn't have the right to subpoena. I didn't have a lot of the things that the IG Act provides me with.

Mr. BILIRAKIS. OK. But prior to June 1981, how were you employed?

Mr. SHERICK. I was the Deputy Assistant Secretary of Defense—Program Budget. I was the budget officer.

Mr. BILIRAKIS. And that was——

Mr. SHERICK. For 7 years.

Mr. BILIRAKIS. Oh, that was prior to this administration.

Mr. SHERICK. Yes; that was prior to this administration.

Mr. BILIRAKIS. Who appointed you to that position, President Carter?

Mr. SHERICK. It wasn't a presidential appointment. I was appointed by Harold Brown, and before that, I was Deputy Comptroller of the Army. Before that I was in budget for research and development, and I was in the Bureau of the Budget, the Executive Office of the President, for a long period of time. I started out in the Frankford Arsenal in Philadelphia.

Mr. BILIRAKIS. As a Government employee?

Mr. SHERICK. Yes; after I got out of the Navy. I was in the Navy in World War II. I went in early in the war when I was 17, and I served during the whole war. Then I went to college under the GI bill, and I went to law school. I went to work in the Army at Frankford Arsenal, and then came down to Washington and worked in the Army. Then, as I said, I went to the Bureau of the Budget.

I was also the first comptroller of the Defense Nuclear Agency, which was the agency responsible for all nuclear weapons.

Mr. BILIRAKIS. OK. Sir, certainly your background is extensive, and I guess, you presumed what my questions were going to be. You have already answered them. So let me ask just one last question.

Are you in a position to furnish this committee with your ideas, your thoughts, and your suggestions in writing on changing the overall picture. Or do you feel that maybe that would be compromised by virtue of your current position?

Mr. SHERICK. I can tell you what I think. As the IG, I am independent. I can tell you, if that is of any use to you.

Mr. BILIRAKIS. Well, Mr. Chairman, if it isn't of any use to us, then shame on us. It would be a waste of time.

Mr. WYDEN. I think the gentleman makes a good point. We will leave the record open so that there can be written answers to the questions from the gentleman from Florida.

Mr. BILIRAKIS. If you would furnish that to this committee, and maybe a personal copy to my attention, I would appreciate it. And I think we ought to ask Mr. Spanton to do the same thing. I don't know whether he is here today.

Mr. WYDEN. I believe he was asked to do that yesterday, and if not, the gentleman's suggestion is a good one.

Mr. BILIRAKIS. Thank you very much, sir.

Mr. WYDEN. Does the gentleman have any further questions?

Mr. **Bilirakis**. No, thank you.

Mr. **Wyden**. The gentleman from Minnesota.

Mr. **Sikorski**. Mr. Sherick, during September 1984 at a Pentagon news conference, you said that you tried—I presume that is the 26th news conference with Mr. Burch. You said that you tried to win convictions against fraudulent contractors but the prosecutors are often reluctant to undertake a complicated and possibly lengthy trial in pursuit of a single conviction, and you spoke to that earlier today.

You said that only by appealing to the prosecutor's patriotism have you started to persuade them to take on more of your tough cases. You explained that as a result of your "missionary work" among U.S. attorneys, many of them were becoming more sensitive to the Pentagon's prosecution needs.

Do you recall making that statement?

Mr. **Sherick**. Yes.

Mr. **Sikorski**. With this in mind, I think we all agree that the Los Angeles area, with 1,746 contractors performing on defense contracts worth $13.7 billion, should be of prime interest to any organization responsible for detecting fraud, waste and abuse in defense programs.

When did you open the DCIS investigative office in Los Angeles?

Mr. **Sherick**. About 2½ years ago. It was not directly in Los Angeles, it was outside of Los Angeles, but I opened it about 2½ years ago.

Mr. **Sikorski**. You have 16 criminal investigators in the Los Angeles area. Are these DCIS investigators?

Mr. **Sherick**. Yes.

Mr. **Sikorski**. How many procurement fraud investigations are currently under investigation by this office?

Mr. **Sherick**. I don't have the data with me, but I could certainly provide them.

Mr. **Sikorski**. If you will.

How many procurement fraud cases you have referred for prosecution to the U.S. attorney's office in Los Angeles?

Mr. **Sherick**. Again, I would have to provide that to you.

Mr. **Sikorski**. And would you provide also how many of your procurement fraud investigations have resulted in criminal indictment? I presume you know that.

Mr. **Sherick**. I don't know off-hand.

Mr. **Sikorski**. Have you gotten any criminal indictments or prosecutions in the Federal judicial district which encompasses Los Angeles?

Mr. **Sherick**. I can't really answer that. I know we have gotten indictments, but I'm not sure how many; but I could, again, tell you for the record.

Mr. **Sikorski**. Do you know if any major contractors have been indicted or prosecuted in the Los Angeles area?

Mr. **Sherick**. I know that there are investigations going on against major contractors. Again, I wouldn't want to rely on my memory.

[The following information was received:]

The DoD, Office of Assistant Inspector General for Investigations office covering Los Angeles is staffed by 16 special agents and 2 support personnel. They have referred approximately 40 cases for criminal prosecution. Of these cases, four have resulted in indictment and conviction. The four indictment convictions consist of two Civilian Health and Medical Program of the Uniformed Services cases and two procurement fraud cases. One of the procurement fraud cases was prosecuted by main justice. The Los Angeles United States Attorney's office indicted the other case on May 25, 1985.

Mr. SIKORSKI. Are you satisfied with what is happening in the Los Angeles area thus far?

Mr. SHERICK. No.

Mr. SIKORSKI. Do you have some plans to make some changes there? Some of those are open positions?

Mr. SHERICK. Yes, we are going to put more people out there, and we are opening another office in California. We are adding more people in our office in Seattle. I am opening seven more offices in the next several months.

Mr. SIKORSKI. Well, is a part of the problem with the district attorney down there that they are focusing on——

Mr. SHERICK. Bank robberies. Bank robberies are a big business in Los Angeles.

Mr. SIKORSKI. So they are focusing on that as opposed to the white collar——

Mr. SHERICK. Yes. The U.S. Attorney has to use his head in deciding what is important. I keep pressing what I think is important; but as I said, I think there are eight bank robberies a day in Los Angeles.

Mr. SIKORSKI. Well, there are millions of people living there, but some of the problems in this, as you pointed out, are that you have gotten millions of dollars in white collar crime, called fraud, here, and hundreds of dollars in these bank robberies. You have to almost personally intervene?

Mr. SHERICK. We send them letters. We call them. We talk to them. We try to give them assistance. We help them. We do everything we can but stand on our head. That is our job, to try to get our cases handled. It requires persuasion. Each one of those 94 U.S. attorneys are independent individual out there doing his thing.

Mr. SIKORSKI. You have talked about the revolving door not sweeping you up, and then there is a lot of talk about the revolving door being a component of the problems that we have in this area. What is your analysis of that problem?

Mr. SHERICK. I think the revolving door is a problem. I think it is more of a problem on the way out than in.

Mr. SIKORSKI. You don't have people leaving the defense industry to come into government?

Mr. SHERICK. No. I think it's the other way around. People leaving the government to go out and get a job, working for a contractor with whom they just placed a contract.

Mr. SIKORSKI. And also we heard testimony yesterday that people who didn't get along with defense contractors in the promotion hearings or discussions were ruled out in favor of those who did get along with the contractors. Could it be that the people in those positions, in some of these contracting officer positions, are looking at what is happening 2 and 3 years from now in their own lives and that affects their judgment? Especially if there is no premium placed internally on promotion, on being a tough——

Mr. SHERICK. Yes, I agree with you. I think it is. I think that there should be a rule that, you know—first of all, the concept of criminal prosecution of those actions doesn't work. I believe we have had one conviction in the conflict of interest law.

You have to put it some way that is going to cost people money and is going to cost the contractor money. I think there should be a cooling off period when somebody leaves the Government. He can certainly not go to work for a contractor for a certain amount of time. I think it has to be a reasonable amount of time or you are not going to get good people, but I think there has to be a cooling off period so he can't go to work for those contractors.

Mr. SIKORSKI. Would you do this for me? Look at instances that you have discovered over in the IG's office of these kinds of situations under the title of Revolving Door and report back?

Mr. SHERICK. Yes, I certainly will.

Mr. SIKORSKI. Thank you, Mr. Chairman.

Mr. WYDEN. Mr. Sherick, you have been very patient. As you can tell, the members have strong views on the issues that we discussed. I think the gentleman from Florida made a very appropriate request to have in writing your suggestions for how we turn the situation around; and unless you have any further comment, we will excuse you at this time.

Mr. SHERICK. Well, I would like to stay here all afternoon.

But no, thank you.

I would like to say just one other thing, that if you have been impressed with me, you should meet my deputy because he is really a class act. Between the two of us, I think we are earning our money; not much, but we are earning it.

Mr. WYDEN. We thank you for coming. There will also be, Mr. Sherick, some written questions that will be submitted to you as well.

[Testimony resumes on p. 656.]

[The following material was received:]

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D C 20301

RECEIVED
JUN 14 1985
Subcommittee on
Oversight and Investigations
5:00 p.m.

14 JUN 1985

Honorable John D. Dingell
Chairman, Subcommittee on
Oversight and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

I am enclosing the edited copy of the transcript of my appearance before the Subcommittee on April 24, 1985.

The inserts that follow page 124 are reports of investigation by the Office of the Inspector General and are "For Official Use Only." They should not be released outside the Committee. The insert requested on pages 175-176 is being provided to you under separate cover because of the sensitive nature of the material contained therein.

The investigation concerning Vice Admiral Metcalf will be provided to you as soon as it is available and is released.

The information requested on pages 224 and 225 is not available at this time. I have made many suggestions to the Defense Council on Integrity and Management Improvement concerning improvements to the acquisition process. My recommendations, as well as those of other Defense officials, are now being considered by the Secretary of Defense. After the decisions are made on these suggestions, I shall furnish the Committee with the material it has requested.

If you or your staff have any further questions regarding this transcript, please contact Mr. Richard D. Lieberman at 697-6035.

Sincerely,

Derek J. Vander Schaaf

for
Joseph H. Sherick
Inspector General

Enclosure

NINETY-NINTH CONGRESS

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U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

October 1, 1985

The Honorable Joseph H. Sherick
Inspector General
Department of Defense
The Pentagon
Washington, D. C. 20301

Dear Mr. Sherick:

Thank you for your candid and helpful testimony before the Subcommittee on Oversight and Investigations on April 24, 1985. The Inspector General's office is a vital force in our government's efforts to insure that the American taxpayer is not defrauded by our large defense contractors.

The Subcommittee, as you know, has been concerned for some time that certain major corporations have been literally out of control in their abuse of the government they are supposed to serve and the taxpayers who must pay the bill. We have found examples of illegal gratuities being provided to military officers and other government employees; stock manipulation; falsification of books and records; fraudulent claims; and the deliberate vouchering of clearly unallowable costs such as dog boarding, pleasure travel on corporate aircraft, and country club dues. These wrongdoings have involved the top leadership of these companies -- a clear reflection on the integrity of these executives.

While these examples are issues of concern to the Securities and Exchange Commission (SEC), as well as to the Subcommittee, they should also be of concern to the Inspector General. The Inspector General, sometimes in conjunction with other enforcement agencies, must perform well if these abuses are to be corrected and to be prevented from occurring in the first place. This is why the Subcommittee needed your appearance on April 24 and has requested certain information from your office.

On April 16, 1985, the Subcommittee requested reports of all significant incidents involving criminal investigations submitted to the Inspector General since July 28, 1983, pursuant to DOD Instruction 5240.4. On June 21, 1985, you informed the

Subcommittee that providing copies of the significant incident reports is neither useful for the Subcommittee's purposes nor productive of Inspector General staff time. In a June 28, 1985 letter to my colleague, the Honorable Bill Nichols, Chairman, Subcommittee on Investigations, Committee on Armed Services, Derek J. Vander Schaaf, Deputy Inspector General, advised that he did not submit this information because he thought it would be desirable to protect the information and would serve no purpose for the Subcommittee.

As you know, the Inspector General's office has no authority to withhold any information requested by the Subcommittee. It has been made clear in discussions between our respective staffs that it would be acceptable for you to delete the names of all open criminal investigations. Further, the Subcommittee staff advised your office that it was understood that this information is readily available in one location -- the office of your Assistant Inspector General for Criminal Investigations Policy and Oversight, Michael C. Eberhardt. It is requested that the Subcommittee's April 16 request be satisfied without further delay.

At the April 24 hearing, you were asked to furnish the Subcommittee with your thoughts and suggestions for improving the defense procurement system. You indicated that, as the Inspector General, you were independent and could tell us what you thought. In a letter dated June 14, 1985, signed by Mr. Vander Schaaf, he indicated that your thoughts and suggestions were not available at that time. Mr. Vander Schaaf indicated that the recommendations that you have made are now being considered by the Secretary of Defense and that only after decisions are made on these suggestions, will your thoughts and suggestions be furnished to the Subcommittee. This response is highly curious. The Subcommittee is interested in your thoughts and suggestions, not those of Secretary Weinberger or other defense officials. Were you instructed not to furnish your thoughts and suggestions to the Subcommittee? The Subcommittee would appreciate being furnished with your thoughts and suggestions or with an explanation as to why such information cannot be furnished.

As you know, some contractors have raised questions about the accuracy of the list of open Department of Defense investigations involving the top 100 defense contractors that you furnished the Subcommittee on June 14. We are, therefore, requesting the following information regarding the open investigations involving the 36 contractors listed: the date the case was opened; the source of the allegation; the substance of the allegation; identification of the division under investigation; the current status of the investigation; and any additions or deletions to the list subsequent to its preparation.

Finally, it is requested that the enclosed questions, which pertain to the April 24 hearing, be answered and responses returned to the Subcommittee by Monday, October 21, 1985.

Your continued assistance in helping the Subcommittee gain a better understanding of the role played by the Inspector General and the Department of Defense investigative agencies in the matter of the General Dynamics Corporation and other major defense contractors is greatly appreciated. Please contact Messrs. Peter Stockton or Jeffrey Hodges of the Subcommittee staff at 225-4441 if you have any questions.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

Enclosure

ENCLOSURE

1. On May 21, 1985, Navy Secretary John Lehman advised you that he did not agree with your recommendations regarding the immediate suspension of General Dynamics executives David Lewis, Gorden MacDonald and George Sawyer.

   a. Why was the decision made that you write to Secretary Lehman on May 2, 1985, instead of to the other service secretaries or even to Secretary Weinberger? Who made this decision?

   b. Do you agree with Secretary Lehman's explanation as to why he was not acting on your recommendation?

   c. Following Secretary Lehman's refusal to act on your recommendation, did you bring this matter to the attention of the Secretaries of the Air Force and Army? Did you bring this to the attention of Secretary Weinberger?

   d. Please furnish copies of any letters or memoranda pertaining to the above notifications.

2. You testified that you have conducted a number of oversight projects designed to identify areas where improvements may be required, including suspension and debarment actions. Please furnish copies of these studies. Did you find that more severe action is being taken against small contractors than large contractors? Please list the large contractors that have been suspended or debarred and the reasons for such action. Who will receive any recommendations that you may make as the result of your oversight projects?

3. You discussed the problem of contractors' providing gratuities to government officials. Has it been your experience that when you learn of contractors who have furnished gratuities to DOD civilian and military personnel, such as expensive dinners, fishing trips, expensive gifts, and vacation travel, you have been unable to obtain Department of Justice interest or support in prosecuting the contractors?

   a. Do you believe that the only way to put an end to this pervasive problem is by prosecuting such contractors and the responsible individuals and letting your actions serve as notice to others in the defense community that the giving of gratuities will not be tolerated by the DOD?

b. Have you discussed this approach with the Defense Procurement Fraud Unit and referred appropriate allegations to them for their investigative/ prosecutive consideration? What was their response?

c. Have you tried to enlist support from the Department of Justice Public Integrity Section? If so, what was its response?

d. What else have you done to obtain the necessary prosecutive support to permit you to deal with this problem?

4. You testified that you have taken a variety of actions to alert DOD employees to the problems ensuing from gratuities. You also said that in July 1984, your office initiated a project to review the current policies of major DOD contractors in relation to gratuities.

a. How many gratuity cases have you investigated during the past two years? How many of these cases involved senior DOD (including military) personnel?

b. Describe in specific terms the results to date of your gratuities project, including the number of referrals, and the number of prosecutions;

c. Furnish copies of your recommendations to the DOD General Counsel on the gratuities issue.

5. You mentioned that you have been very concerned with the improprieties by General Dynamics regarding the shipbuilding contracts and have been actively involved in oversight of all criminal investigations of General Dynamics.

a. When did you begin to become concerned?

b. Describe the actions that you have taken. To whom have you expressed your concerns? Please furnish any documentation that is relevant in this regard.

c. Describe the nature of your oversight of all criminal investigations of General Dynamics. Does this mean that your office is reviewing actions being taken by the Justice Department, the grand jury, the Internal Revenue Service, the Securities and Exchange Commission, the Naval Investigative Service, and other investigatory bodies?

6. The Subcommittee has been furnished with a copy of your April 22, 1985 memorandum for the Assistant Secretary of the Air Force (Financial Management), which pertains to your review of the testimony of Mr. A. Ernest Fitzgerald. Mr. Fitzgerald, as you know, had been scheduled to appear at the Subcommittee's hearing on April 24, 1985. In your memorandum, you indicated that you had found the last two paragraphs of Mr. Fitzgerald's testimony to be "factually inaccurate and/or misleading." You also stated that the paragraph on pages 7-8 represents an "unfair and inappropriate attack on an outstanding civil servant."

   a. Please explain specifically what you found to be "factually inaccurate and/or misleading."

   b. Please explain what you meant by "unfair and inappropriate attack on an outstanding civil servant." Who is this outstanding civil servant?

   c. Have you been asked to review Mr. Fitzgerald's testimony when he appeared before the Congress on other occasions? Did you have problems with Mr. Fitzgerald's testimony on those occasions? In what way?

7. You testified that your office has 100 open auditor positions, 59 open criminal investigator positions, and a plan to hire an additional 400 criminal investigators. You indicated that you are "killing yourself" to hire these people but that it is tough to get good people in this Government. Why is it so difficult for you to get good people?

8. The 1983 report by the GAO described a number of inadequacies in the commitment of the military services' own investigative organizations to attack white collar crime in DOD programs. Your recent report to Congress states that "Secretary Weinberger established DCIS in October 1981 as an elite group to fight white collar crime". DCIS was assimilated into the Office of Inspector General of the DOD when it was statutorily created in September 1982.

a. Section 5 of the Inspector General Act of 1978, requires the IG to prepare semi-annual reports which list, among other things, a description of significant problems relating to the administration of programs and operations during the reporting period. Have you used this vehicle to let Congress know of the problems you have been experiencing in obtaining prosecutive support in certain geographical areas, such as the Los Angeles area?

b. When did you open the DCIS investigative office in Los Angeles?

c. How many procurement fraud investigations are currently under investigation by this office?

d. How many procurement fraud cases have you referred for prosecution to the U.S. Attorney's Office in Los Angeles?

e. How many of your procurement fraud investigations have resulted in criminal indictment or prosecution in the Federal Judicial District which encompasses Los Angeles? What were the dates of these indictment and prosecutions? Has the recent action in this area been due to the concerns raised by the Congress?

f. What major contractors have been indicted or prosecuted in the Los Angeles area?

g. Are you satisfied with these results?

h. What have you done to improve this situation?

i. How has the Defense Procurement Fraud Unit assisted you in resolving this problem?

j. Information furnished by your office indicates that you have DCIS field offices in Orlando, Florida and Dallas, Texas. When did you open these field offices? How many agents are assigned to each office?

k. The press releases furnished by your office do not appear to show any activity by these offices. Please indicate, for each respective office, the number of open procurement fraud investigations involving major defense contractors. How many prosecutor reports have been submitted for prosecutive consideration? How many indictments and convictions have you obtained? When were these obtained? Are you satisfied with the results from Orlando and Dallas? What is your analysis of the problem?

1. What is your largest single field office from the standpoint of investigative resources? How many prosecutor reports have been submitted for prosecutive consideration? How many indictments and convictions have you obtained against major defense contractors? When were these obtained? Are you satisfied with these results? What is your analysis of the problem?

9. The Subcommittee staff informed the Ethics Officer for the Office of the Secretary of Defense, in early March of this year, that DOD Assistant Secretary for Public Affairs, Michael Burch and other senior DOD officials, accepted gratuities from General Dynamics. Subsequent to that time, the Subcommittee staff briefed a criminal investigator from the Defense Criminal Investigative Service on this matter. On April 22, 1985, your office advised the Subcommittee staff that the Defense Criminal Investigative Service had opened an investigation into this matter. You testified that, during this seven-week period, your office had not been informed of the provision of illegal gratuities nor did the Secretary's office request action by your office on this matter.

   a. Should the DOD's Ethics Officer have referred this information to the Inspector General?

   b. Does the Ethics Officer offer an explanation for not referring this matter to the Inspector General?

10. You testified that you performed a review in 1983 of the Defense Contract Audit Agency's reporting of contractor fraud. You stated that you found cases of untimely referrals, improper disclosures to procurement officials, failure to refer irregular conduct, and inadequate controls to assure timely referral. You further advised that your current follow-up review shows that DCAA has taken corrective action and shown major improvement in this area.

   a. Please furnish copies of your 1983 and current reviews.

b. You indicated that fraud referrals by DCAA have risen nearly fivefold -- increasing from 26 in fiscal year 1981 to 39 in 1982 to 60 in 1983 and to 125 in 1984. To what do you attribute this increase?

11. You indicated that cost mischarging is one of your priorities. Describe why you have designated this type of violation as a priority.

a. Please identify the DOD cost mischarging investigations that have resulted in successful prosecutions since you became IG. List the contractors that are being investigated for cost mischarging and that have been referred for prosecution. How much money is involved?

b. How many were prosecuted by the: (1) Defense Procurement Fraud Unit; (2) Department of Justice Fraud Section; (3) U.S. Attorneys?

c. Have you identified in your "Semiannual Report to the Congress", the problems in securing prosecutive support in this area from the Department of Justice?

12. You indicated that defective pricing is also one of your priorities. Please explain why you have designated this type of violation as a priority? Identify the DOD defective pricing investigations that have resulted in successful prosecutions since you became IG. List the contractors that are being investigated for defective pricing and that have been referred for prosecution. How much money is involved?

13. You testified concerning your dissatisfaction with the lack of criminal prosecutions by the Department of Justice on cost mischarging and defective pricing cases. You said you "keep pounding them to the Procurement Fraud Unit" and that often the only thing you can do is to "make a lot of noise." You said you intended to go to Secretary Weinberger soon and that you were confident he would help out by signing letters in support of the IG program. Subsequent to your appearance before the Subcommittee, have you sought Secretary Weinberger's support in your effort to obtain better prosecutive support from the Department of Justice? If so, provide details.

14. You testified that you have hurt major contractors in the pocketbook. You provided as examples your recommendations that General Electric refund $168 million and that Pratt & Whitney refund $48 million.

    a. Have you asked the Department of Justice to file civil actions to recover the money which you feel belongs to the Government?

    b. Please provide full details on these two situations specifically, and on the lack of civil actions to recover such sums in general.

    c. Can you furnish other examples of where the IG's efforts have hurt the major defense contractors in the pocketbook?

15. You testified that you have written "a couple of letters trying to get [the U.S. Attorney in Miami] to move on [the Pratt & Whitney case]." Please provide copies of those letters and any other documentation available to your office concerning difficulties in securing timely prosecutive action by the Department of Justice in this matter.

16. You testified that you have written to Assistant Attorney General "Steve Trott and people like that" to get action by U.S. Attorneys on 28 cases including General Dynamics. Please provide copies of those letters and any responses from the Department of Justice. You also indicated that when this avenue is unsuccessful you have to seek prosecutive support by requesting the Secretary of Defense to write to the Attorney General. If you have requested that the Secretary support you in this manner, describe the situations and responses received. Include copies of relevant correspondence and supporting documentation.

17. Your news release of September 26, 1984, advised that during the prior two and one-half years, DOD investigators had conducted 39,000 criminal investigations and that 17,000 had been referred for prosecution or administrative action resulting in 1,300 convictions. More recently, Deputy Defense Secretary William Taft, IV, testified before a House Armed Services Subcommittee hearing that, in the last three years, 20,000 contracting cases have been referred for prosecution or administrative actions, resulting in more than 1,500 convictions, some of which resulted in fines and long jail terms.

a. Are Mr. Taft's figures correct?

b. Please provide for the record, with regard to each of these figures, what percentage represents significant incidents or cases (as defined by DOD Instruction 5240.4).

c. Based on our review of the documentation which you have submitted to the Subcommittee, it would appear that the significant cases which you are investigating and prosecuting constitute a very small percentage of the figures furnished in your news release. Is it not true that the 39,000 investigations you referred to in your news release include such matters as:

-- A serviceman filed a travel voucher for living quarters expenses. The travel office, identifying an overcharge, sent the voucher to the investigative agency, which found an overpayment of $18. The individual denied any intent to defraud the government while admitting that he had received excess reimbursement.

-- An individual claimed excessive tips on his travel voucher. A travel section supervisor notified the investigative agency. The traveler admitted he had falsified his claim to receive maximum per diem. The amount overpaid was $46.

-- A serviceman prepared fraudulent promotion orders, which caused his payment for unused leave to be made at a higher rate. He received an excess $222. Records management personnel uncovered the transaction and the offender was reprimanded.

-- An employee was investigated for charging $26 in unauthorized long distance telephone calls. The employee was warned and $26 was recouped. In this case, other employees responsible for communications already knew the identity of the caller before the investigators were notified.

-- A meat cutter at a commissary offered special butcher services during duty hours. Nothing indicated that he was paid by customers for the services. He was admonished, his personnel file was annotated, and other employees were warned not to engage in this practice. No money was lost.

-- Theater cashiers bypassed internal control procedures and personally paid for shortages while not disclosing excess receipts from ticket sales. The Army-Air Force Exchange Service, which oversees the theaters initiated the investigation. Overages and shortages were about $5. Investigators found there was no intent to steal. Proper controls were reinstated.

d. With all the major crimes that are going uninvestigated, and billions of taxpayers' dollars being wasted, why is not a larger percentage of DOD's investigative resources being marshalled where it would do the American taxpayer the most good -- that is, *major* theft and procurement frauds?

e. Of the 3,629 DOD criminal investigators under your functional authority, how many were engaged in the investigation of similar minor matters? Conversely, how many of these investigators spent the majority of their time investigating *significant* procurement frauds?

18. In the July 12, 1984 issue of the *Pittsburgh Press*, in response to criticism for going after "nickel and dime" fraud cases while leaving the big defense contractors alone, you were quoted as saying that you expected criminal indictments in the fall of 1984, as a result of your investigations, of about 15 *major* corporations.

a. Please identify these 15 major corporations.

b. Please tell us what happened to those indictments?

c. In a speech on July 19, 1984, to the Procurement and Trade Conference in Indianapolis, Indiana, Secretary Weinberger stated that indictments of 15 "major" defense contractors were expected in the fall of 1984. What was the source of Secretary Weinberger's information?

d. Did he make this pronouncement based on your statement of several days earlier? Or was he referring to another 15 indictments that were anticipated?

e. Are enough investigators actually working your investigations to enable them to obtain adequate evidence and, where appropriate, refer the matter to the Department of Justice for prosecutive determinations and action, or are they merely opening more and more cases which never get fully investigated and resolved?

19. You testified concerning global settlements where civil, criminal, and administrative problems are all wrapped into one settlement agreement between a contractor and the Government. These usually result in a decided advantage to the contractor and corresponding disadvantage to the Government. You clearly rejected this concept stating that "it's not ... never was" the policy of the Inspector General. There appears to be some confusion because the Subcommittee was advised in a memorandum prepared by your Criminal Investigations Policy and Oversight Office and dated April 16, 1985, that the DOD IG "actively supports global settlements."

a. Please provide the official IG policy regarding global settlements.

b. Please provide copies of whatever guidance you have provided to the DOD criminal investigators, prosecutors, auditors, and other concerned parties, on this subject.

c. Please summarize the problems you have found with global settlements, such as with the Sperry case. Have you experienced problems with other global settlement cases?

20. With respect to your audits of the spare parts scandal, you testified that "we took an awful lot of punishment from everybody for doing that, from within the Department of Defense, from the contractors and from everyone else."

a. Please explain what you meant by "we took an awful lot of punishment".

b. You testified that you found 95 contractors had overpriced parts to the DOD, that you have audits underway at these 95 contractors, and that you are referring defective pricing problems to your criminal investigators. Please provide a status report showing your findings to date. Please include the number of cases that have been referred for criminal investigation. Are any of these cases major defense contractors? Have you been successful in going for refunds in those instances where you cannot prove defective pricing but where the contractor's pricing is out of line?

21. The Cost Accounting Standards Board was disbanded about 4 years ago, after being in existence for many years. You testified that you have recommended that the CASB be reinstituted. Please explain why you made this recommendation.

22. You mentioned that you did an audit of contracting officers and procurement officials and concluded that 67 percent of them were not well-trained and that the system was not training them. When was this audit performed? To whom did you report these findings? Describe the actions that have been taken to correct this serious problem.

23. Subsequent to the April 24 hearing, you furnished additional information in which you advised that you agree that the kind of reviews proposed by Mr. Colin D. Parfitt in an April 5, 1985 memorandum are necessary. Mr. Parfitt, as was explained at the hearing, had faulted the IG's auditors for not performing constructive analysis and evaluation in connection with the IG's final report on the audits of aircraft engine spare parts pricing. You also advised that while such reviews are necessary, the question is how and when to do them.

    a. Please describe specifically what you are going to do. When will your actions be accomplished?

    b. What changes do you plan to make?

24. You testified that there has been only one instance in which you found it necessary to seek enforcement of a subpoena by seeking the order of a United States District Court. You cited the Westinghouse Corporation as being the contractor involved. Please describe the circumstances surrounding this matter and provide the current status. Have your experienced any other instances where Westinghouse has not cooperated with the IG in a proper manner?

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

22 OCT 1985

Mr. John D. Dingell
Chairman
Subcommittee on Oversight and
  Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

RECEIVED
[illegible] 22 1985
Subcommittee on Oversight
and Investigations

Dear Mr. Chairman:

I have received your letter of October 1, 1985, and am preparing responses to the three questions posed in the letter and the 24 questions in the enclosure.

Because many of these questions require extensive compilation, and since I want to be as responsive as possible, I expect to be able to furnish the responses to you within the next five to ten days.

I appreciate your kind words with respect to my testimony and the support you expressed for the Office of the Inspector General, Department of Defense.

Sincerely,

Joe Sherick

Joseph H. Sherick
Inspector General

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

18 NOV 1985

Mr. John D. Dingell
Chairman
Subcommittee on Oversight and
  Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

RECEIVED
NOV 19 1985
Subcommittee on Oversight
and Investigations

Dear Mr. Chairman:

I appreciate the interest of your Subcommittee in understanding the role of the Inspector General and other Department of Defense investigative agencies in relation to major Defense contractors. I also appreciate your kind words about the Office of the Inspector General, Department of Defense.

I am enclosing responses to the 24 questions attached to your letter of October 1, 1985. As you requested, copies of additional documents are also attached and are cross-referenced in the answers to your questions. I hope this material is helpful and responsive to the Subcommittee's needs.

My office is continuing to prepare the responses to the questions in your letter, and I expect to provide them to you shortly.

I am sending a copy of this letter and its enclosures to Representative Broyhill, Ranking Minority Member of the Subcommittee.

Sincerely,

Joe Sherick

Joseph H. Sherick
Inspector General

Enclosure

INSERT FOR THE RECORD

☐	HOUSE	APPROPRIATIONS COMMITTEE	☐	HOUSE	ARMED SERVICES COMMITTEE	X	HOUSE	OTHER
☐	SENATE		☐	SENATE		☐	SENATE	Energy & Commerce
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO	LINE NO		INSERT NO				Quest. No. 1

Question: On May 21, 1985, Navy Secretary John Lehman advised you that he did not agree with your recommendations regarding the immediate suspension of General Dynamics executives David Lewis, Gorden MacDonald and George Sawyer.

a: Why was the decision made that you write to Secretary Lehman on May 1, 1985, instead of to the other Service secretaries or even to Secretary Weinberger? Who made this decision?

Answer: The basis for the Inspector General recommendation regarding suspension related to matters predominantly affecting the Department of the Navy. Within DoD, when an administrative action is being considered against a contractor which does business with one or more Military Departments (or the Defense Logistics Agency), the lead in such actions is normally taken by the Military Department (or the Defense Logistics Agency), which is predominantly involved in the basis for the action. The Inspector General adheres to this practice. (See the IG memorandum to the Secretary of the Navy attached at Tab 1.)

b: Do you agree with Secretary Lehman's explanation as to why he was not acting on your recommendation?

Answer: No.

c: Following Secretary Lehman's refusal to act on your recommendation, did you bring this matter to the attention of the Secretaries of the Air Force and Army? Did you bring this to the attention of Secretary Weinberger?

Answer: The Secretaries of the Army and the Air Force, as well as the Secretary of Defense were aware of the IG recommendation to the Secretary of the Navy.

d: Please furnish copies of any letters or memoranda pertaining to the above notifications.

Answer: The material is enclosed at Tab 2.

Note: Certain Tabs as enclosed [illegible] can be found in Subcommittee files.

INSERT FOR THE RECORD

	HOUSE SENATE	APPROPRIATIONS COMMITTEE		HOUSE SENATE	ARMED SERVICES COMMITTEE	X	HOUSE SENATE	OTHER Energy & Commerce
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO.		LINE NO.		INSERT NO.			Quest. No. 2

Question: You testified that you have conducted a number of oversight projects designed to identify areas where improvements may be required, including suspension and debarment actions. Please furnish copies of these studies. Did you find that more severe action is being taken against small contractors than large contractors? Please list the large contractors that have been suspended or debarred and the reasons for such action. Who will receive any recommendations that you may make as the result of your oversight projects?

Answer: Recommendations in our oversight reports are generally directed to the office responsible for implementing the required action. Enclosed at Tab 1 is a copy of our May 1984 review of suspension and debarment activities in the Army, Navy, Air Force and the Defense Logistics Agency (DLA), which was issued to the Secretaries of the Military Departments and the Director, DLA. During the time period covered by the study, March 1981-March 1983, it was observed that fraud cases against major contractors were rarely considered for suspension or debarment action. In addition to the suspension and debarment report, I have enclosed the oversight report on investigative operations at Tab 2.

Since the issuance of the suspension and debarment report, each of the Military Departments and DLA has established a system to ensure that every contractor which is indicted or convicted of contract fraud will be considered for suspension or debarment action. For example, the recent convictions of the National Semiconductor Corporation and General Electric resulted in their suspension from Government contracting. The suspensions were lifted after the contractors were able to demonstrate their present responsibility.

The history of suspensions and debarment in DoD shows that there has been a seven fold increase over the past 6 years. This trend is shown on the table below:

Historical Statistics:

Total Suspensions and Debarments for FY 1985:	582
Total Suspensions and Debarments for FY 1984:	594
Total Suspensions and Debarments for CY 1984:	451
Total Suspensions and Debarments for CY 1983:	317
Total Suspensions and Debarments for CY 1982:	163
Total Suspensions and Debarments for CY 1981:	131
Total Suspensions and Debarments for CY 1980:	78

INSERT FOR THE RECORD

HOUSE SENATE	APPROPRIATIONS COMMITTEE	HOUSE SENATE	ARMED SERVICES COMMITTEE	X	HOUSE SENATE	OTHER Energy & Commerce	
HEARING DATE [illegible] 18, 1985	TRANSCRIPT PAGE NO.	LINE NO.	INSERT NO.			Quest. No. 4	

Question: You discussed the problem of contractors' providing gratuities to government officials. Has it been your experience that when you learn of contractors who have furnished gratuities to DoD civilian and military personnel, such as expensive dinners, fishing trips, expensive gifts, and vacation travel, you have been unable to obtain Department of Justice interest or support in prosecuting the contractors?

a: Do you believe that the only way to put an end to this pervasive problem is by prosecuting such contractors and the responsible individuals and letting your actions serve as notice to others in the defense community that the giving of gratuities will not be tolerated by the DoD?

Answer: Yes, I believe prosecutive action coupled with civil and administrative actions is required to deter this type of conduct.

b: Have you discussed this approach with the Defense Procurement Fraud Unit and referred appropriate allegations to them for their investigative/prosecutive consideration? What was their response?

Answer: We have expressed our interest in having these cases prosecuted to the Defense Procurement Fraud Unit. They have indicated a willingness to prosecute contractors where the gratuities meet the Department of Justice prosecutive thresholds. We have also encouraged the use of IG subpoenas to overcome restraints imposed by Rule 6E.

c: Have you tried to enlist support from the Department of Justice Public Integrity Section? If so, what was its response?

Answer: Most of our dialogue on this subject has been with the Defense Procurement Fraud Unit, not the Public Integrity Section, since the Defense Procurement Fraud Unit is our liaison point within the Criminal Division of the Department of Justice.

d: What else have you done to obtain the necessary prosecutive support to permit you to deal with this problem?

Answer: In order to determine the extent of the Department of Justice commitment in this area, my office is closely monitoring a few particularly significant gratuities investigations in order to ascertain the responsiveness of the Department of Justice to accept such cases for prosecution.

In addition, we believe that strong contractual and administrative action is warranted to complement or supplement prosecutive action.

We support contract action under 10 USC 2207 which allows DoD to terminate contracts for default if gratuities are provided, and to exact a penalty from the contractor. This remedy worked successfully in a recent Navy action against General Dynamics, which resulted in a penalty against the contractor for over $600,000. In addition, we have initiated an aggressive briefing program for DoD and contractor employees concerning the prohibitions against gratuities. We believe that given the lack of prosecutions in this area, preventive measures and contractual remedies may prove more effective.

BEST COPY AVAILABLE

INSERT FOR THE RECORD

	HOUSE	APPROPRIATIONS COMMITTEE		HOUSE	ARMED SERVICES COMMITTEE	X	HOUSE	OTHER Energy & Commerce
	SENATE			SENATE			SENATE	
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO		LINE NO		INSERT NO			Quest. No. 4

Question: You testified that you have taken a variety of actions to alert DoD employees to the problems ensuing from gratuities. You also said that in July 1984, your office initiated a project to review the current policies of major DoD contractors in relation to gratuities.

a: How many gratuity cases have you investigated during the past two years? How many of these cases involved senior DoD (including military) personnel?

Answer: During the past two years, my Criminal Investigative Service has investigated 42 gratuities cases, 15 of which dealt with senior DoD officials. In addition to the activities of my criminal investigators, the three Military Service investigative organizations also conducted 169 gratuities investigations from January 1983 to March 1985.

b: Describe in specific terms the results to date of your gratuities project, including the number of referrals, and the number of prosecutions.

Answer: To date, my investigations have resulted in the referral of 26 cases and conviction of six individuals and one corporation regarding gratuities. It should be noted that the gratuities project which I referred to in my testimony is not related to these investigations. The project, which is still in progress, is designed to assess the scope of the problem and make recommendations concerning corrective action by DoD program officials.

c: Furnish copies of your recommendations to the DoD General Counsel on the gratuities issue.

Answer: We have provided informal comments on the gratuities issue to the DoD General Counsel. Our formal comments regarding gratuities will be provided to the Office of General Counsel after we receive the draft revision to the DoD Standards of Conduct Directive for comment.

INSERT FOR THE RECORD

☐ HOUSE ☐ SENATE	APPROPRIATIONS COMMITTEE	☐ HOUSE ☐ SENATE	ARMED SERVICES COMMITTEE	☒ HOUSE ☐ SENATE	OTHER Energy & Commerce	
HEARING DATE April [illegible], 1985	TRANSCRIPT PAGE NO	LINE NO	INSERT NO		Quest. No. 5	

Question: You mentioned that you have been very concerned with the improprieties by General Dynamics regarding the shipbuilding contracts and have been actively involved in oversight of all criminal investigations of General Dynamics.

a: When did you begin to become concerned?

b: Describe the actions that you have taken. To whom have you expressed your concerns? Please furnish any documentation that is relevant in this regard.

c: Describe the nature of your oversight of all criminal investigations of General Dynamics. Does this mean that your office is reviewing actions being taken by the Justice Department, the grand jury, the Internal Revenue Service, the Securities and Exchange Commission, the Naval Investigative Service, and other investigatory bodies?

Answer: My concern with alleged improprieties by General Dynamics (GD) began when I was appointed Assistant to the Secretary of Defense (Review and Oversight) in mid-1981.

Since that time my Criminal Investigations Policy and Oversight staff has consistently monitored the progress of all investigations concerning GD. The process of monitoring and overseeing these investigations has involved close coordination with the Fraud Section, Criminal Division, Department of Justice; various U.S. Attorneys; all four DoD criminal investigative organizations; the Federal Bureau of Investigation; the Securities and Exchange Commission and the Internal Revenue Service. The purpose of this oversight has been to ensure that adequate investigative resources are committed to each investigation, to ensure the most effective use of available investigative resources and avoid duplication of effort.

My concern over alleged improprieties resulted in my request to the Secretary of Defense to direct the Secretary of the Navy to have NIS investigate certain gratuities received by Admiral Hyman Rickover from General Dynamics (Tab 4). I have also directed my own investigators to conduct other investigations involving General Dynamics. I have used my subpoena authority to obtain needed documents and records. Recently, I testified before your subcommittee that I believed that the available information demonstrated a lack of business ethics and integrity on the part of certain GD officials and I recommended that the Secretary of the Navy consider suspension or debarment action against them.

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☐	HOUSE	APPROPRIATIONS COMMITTEE	☐	HOUSE	ARMED SERVICES COMMITTEE	☒	HOUSE	OTHER Energy & Commerce
☐	SENATE		☐	SENATE		☐	SENATE	
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO	LINE NO	INSERT NO					Quest. No. 6

Question: The Subcommittee has been furnished with a copy of your April 22, 1985 memorandum for the Assistant Secretary of the Air Force (Financial Management) which pertains to your review of the testimony of Mr. A. Ernest Fitzgerald.

Mr. Fitzgerald, as you know, had been scheduled to appear at the Subcommittee's hearing on April 24, 1985. In your memorandum, you indicated that you had found the last two paragraphs of Mr. Fitzgerald's testimony to be "factually inaccurate and/or misleading." You also stated that the paragraph on pages 7-8 represents an "unfair and inappropriate attack on an outstanding civil servant."

a: Please explain specifically what you found to be "factually inaccurate and/or misleading."

Answer: The report of my inquiry fully addressed the issue Chairman Roth had asked me to investigate, which was why the Air Force refused to clear Mr. Fitzgerald's statement to the Senate Governmental Affairs Committee on March 1, 1984.

Despite the statements in Mr. Fitzgerald's testimony, we did not dodge any issue in the report. Neither the Air Force nor anyone else attempted to influence the course or the outcome of the inquiry. No evidence was destroyed. The two key witnesses in the case, the Secretary of the Air Force and Mr. Fitzgerald, were questioned under oath and transcripts were made of their testimony. Mr. Fitzgerald, in fact, availed himself of the opportunity to change the transcript of this interview. The modified version of this transcript, with changes made and initialed by Mr. Fitzgerald, is included in the case file. The report contains the investigators' accounts of statements made by witnesses other than Messrs. Orr and Fitzgerald. Because the report contains full accounts of the statements, interview notes were not retained.

Finally, Mr. Fitzgerald was told by my investigators that he could have a copy of the transcript of this interview. He not only received that transcript, but requested and received a copy of the tape recording of his interview. Nothing submitted by Mr. Fitzgerald or anyone else was altered in any way.

b: Please explain what you meant by "unfair and inappropriate attack on an outstanding civil servant." Who is this outstanding civil servant?

Answer: In his statement Mr. Fitzgerald strongly implied that testimony and other material gathered in an official investigation were tampered with by the Deputy Inspector General, Mr. Vander Schaaf. This inference is not true. Further, I believe Mr. Fitzgerald's statement is an unfair and inappropriate attack on Mr. Vander Schaaf, an individual who has served both the Department of Defense and the House of Representatives with the highest competence and integrity for over 20 years, as both former Chairman Mahon and current Chairman Addabbo can attest.

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☐	HOUSE	APPROPRIATIONS COMMITTEE	☐	HOUSE	ARMED SERVICES COMMITTEE	☒	HOUSE	OTHER
☐	SENATE		☐	SENATE		☐	SENATE	Energy & Commerce
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO		LINE NO		INSERT NO.			Quest. No. 6 cont.

C: Have you been asked to review Mr. Fitzgerald's testimony when he appeared before the Congress on other occasions? Did you have problems with Mr. Fitzgerald's testimony on those occasions? In what way?

Answer: The only other times we were asked to review a statement by Mr. Fitzgerald was prior to his scheduled appearance before the Senate Governmental Affairs Committee in March 1984 and the Senate Judiciary Subcommittee on Administrative Practice and Procedure in June 1984. This was done as part of our normal responsibility to review selected statements by DoD officials who appear before congressional committees to give testimony of interest to our office. In neither case did we object to Mr. Fitzgerald's statement.

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☐	HOUSE	APPROPRIATIONS COMMITTEE	☐	HOUSE	ARMED SERVICES COMMITTEE	☒	HOUSE	OTHER
☐	SENATE		☐	SENATE		☐	SENATE	Energy & Commerce
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO		LINE NO		INSERT NO			Quest. No. 7

Question: You testified that your office has 100 open auditor positions, 59 open criminal investigator positions, and a plan to hire an additional 400 criminal investigators. You indicated that you are "killing yourself" to hire these people but that it is tough to get good people in this Government. Why is it so difficult for you to get good people?

Answer: Difficulties arise from:

- Competition from private industry for outstanding auditors.
- Differences in pay schedules that favor private industry employment.
- Processing time to get a new Government employee selected, cleared, and on board.
- Travel demand due to the nature of our world-wide responsibilities.

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HEARING DATE [illegible] 1985	TRANSCRIPT PAGE NO	LINE NO	INSERT NO	[illegible]			

Question: The 1983 report by the GAO described a number of inadequacies in the commitment of the Military Services' own investigative organizations to attack white collar crime in DoD programs. Your recent report to Congress states that "Secretary Weinberger established DCIS in October 1981 as an elite group to fight white collar crime." DCIS was assimilated into the Office of Inspector General of the DoD when it was statutorily created in September 1982.

a: Section 5 of the Inspector General Act of 1978, requires the IG to prepare semiannual reports which list, among other things, a description of significant problems relating to the administration of programs and operations during the reporting period. Have you used this vehicle to let Congress know of the problems you have been experiencing in obtaining prosecutive support in certain geographical areas, such as the Los Angeles area?

Answer: We have not raised this issue in the semiannual report because we believed it was not necessary to do so. The prosecutive problems I raised are the result of a number of underlying factors. Chief among these are the current number of prosecutors/attorneys available to work on DoD cases, the generally higher levels of complexity of DoD procurement fraud cases relative to other criminal cases, and legitimate differences of opinion based on personal judgments. I believed that these underlying factors were being addressed in my continuing dialogue with the Department of Justice.

The required number of attorneys and the relative priority of DoD cases, due to their complexity and other considerations, are factors that I believe we can resolve. If for some reason they remain unresolved, I will not hesitate to raise these issues to the Secretary and to the Congress. The particular personalities and judgments involved in a prosecutive case are the normal problems we continually deal with in the administration of a complex program. We believe these can be resolved between ourselves and the Department of Justice. Indeed, it was this type of cooperation which led to establishment of the Joint Defense Procurement Fraud Unit. My staff and I have been involved continually in dialogue with the Assistant Attorney General for the Criminal Division and with many U.S. Attorneys to address this particular problem.

b: When did you open the DCIS investigative office in Los Angeles?

Answer: The DCIS Los Angeles Field Office and its subelement at El Segundo, CA, were opened in March 1982 with 9 agents. It currently has 27 agents.

c: How many procurement fraud investigations are currently under investigation by this office?

Answer: The Los Angeles DCIS field office has [illegible] open procurement fraud investigations throughout California, Arizona, and New Mexico. The number of these cases with venue in the Central Judicial District of California is [illegible].

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d: How many procurement fraud cases have you referred for prosecution to the U.S. Attorney's Office in Los Angeles?

Answer: The DCIS has referred 28 of these cases to the U.S. Attorney's Office, Central Judicial District, for prosecutive consideration.

e: How many of your procurement fraud investigations have resulted in criminal indictment or prosecution in the Federal Judicial District which encompasses Los Angeles? What were the dates of these indictments and prosecutions? Has the recent action in the area been due to the concerns raised by the Congress?

Answer: Two procurement fraud investigations initiated by DCIS-LA have resulted in criminal indictments and convictions in the Central Judicial District of California. District International Supply Company, Costa Mesa, CA, and two individuals were indicted on May 21, 1985. A guilty plea was entered on August 6 1985, and sentencing was on September 11, 1985. Systems Engineering Technology Associates Corporation and one individual were indicted on June 6, 1985. Both defendants entered a guilty plea on September 9, 1985, and sentencing is pending.

The DCIS has been investigating procurement fraud in the Los Angeles area since 1982. In addition to DCIS' efforts, various other DoD investigative organizations have investigated procurement fraud cases in the Central Judicial District of California. DCIS-LA, since its inception, has maintained a close working relationship with the U.S. Attorney's Office in Los Angeles. We have, however, expressed our concern about the need for prosecutive support on DoD cases (See Tab 5).

The investigation of complex procurement fraud cases frequently takes several years to reach the courtroom. The two recent indictments of District International and Systems Engineering resulted from cases which were initiated respectively in March 1984 and July 1983. Through these joint efforts and our strong commitment to ferret out fraud within the DoD contracting community over the past few years, I am convinced that we are beginning to send a clear and convincing message to those within this region that we truly mean business. Media interest in support of our efforts to combat fraud and waste in DoD programs is helping our efforts in the Los Angeles area.

It should also be noted that the U.S. Attorney in the Central Judicial District of California has undertaken 10 recent prosecutions relating to kickbacks from subcontractors to DoD prime contractors. While these cases were originally based on FBI investigations, the DCIS has now joined with the FBI in pursuing additional similar allegations in the Central Judicial District of California.

f: What major contractors have been indicted or prosecuted in the Los Angeles area?

Answer: As previously stated, we recently indicted District International Supply Company, Costa Mesa, CA, its president and vice president, both of whom plead guilty to substituting inferior

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metal/steel to the DoD. The president was sentenced to one and one-half years in jail and the vice president sentenced to six months in jail. Additionally, these individuals were ordered to make restitution of $236,948. Also, a $1.1 million civil fraud case and a $500,000 administrative recoupment action are still pending against them.

The other company, Systems Engineering Technology Associates Corp. (SETAC) and its owner plead guilty to making false claims and false statements and mail fraud. Administrative proceedings against them are continuing and are expected to result in recoveries of $400,000.

Both of these companies are multi-million dollar prime contractors with DoD.

g: Are you satisfied with these results?

Answer: No, I am not satisfied with these results. That is why we continue to add agents and will continue to do so over next few years. Also, we are seeking greater assistance from DCAA. However, my staff has recently met with the U.S. Attorneys in Los Angeles and I am encouraged by the progress of their efforts on some of our complex investigations.

h: What have you done to improve this situation?

Answer: We have increased agent strength from 9 to 27. I have written a letter to the U.S. Attorney in Los Angeles to express my concerns and solicit his help to aggressively prosecute defense procurement fraud (Tab 5). My Assistant Inspectors General for Investigations and for Criminal Investigations Policy and Oversight have met with the U.S. Attorney to discuss our need for more criminal prosecutions. In response, the U.S. Attorney has simplified the procedures for initial review and acceptance for prosecution of DCIS referrals. This change should speed the prosecutive process. The U.S. Attorney, in recent press releases, has voiced his support for the prosecution of DoD procurement fraud cases. These actions combined with the two recent indictments are positive steps. I anticipate that the U.S. Attorney will continue to provide evidence of his support through indictments and convictions.

i: How has the Defense Procurement Fraud Unit assisted you in resolving this problem?

Answer: The Defense Procurement Fraud Unit has assigned prosecutors to work with the prosecutors from the Central Judicial District in California on procurement fraud investigations concerning two major defense contractors. The Fraud Unit and this U.S. Attorney's Office simultaneously are provided a copy of all DCIS prosecutive referrals concerning major DoD procurement fraud cases. This procedure allows the Fraud Unit to track all of the prosecutive referrals and provide expertise regarding complex fraud investigations to those U.S. Attorney offices that have little prosecutive experience in these types of investigations/prosecutions.

j: Information furnished by your office indicates that you have DCIS field offices in Orlando, Florida, and Dallas, Texas.

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When did you open these field offices? How many agents are assigned to each office?

Answer: The DCIS resident agency at Orlando, FL, (a subelement of the DCIS field office at Atlanta, GA) was opened in May 1983 and staffed with two special agents. As of September 30, 1985, the Orlando Resident Agency consisted of four special agents.

The DCIS office at Dallas, TX, was elevated to a field office level in August 1984. Previously, from December 1981 to July 1984, it was a resident agency consisting initially of two special agents. Currently, it is staffed with 10 special agents.

k: The press releases furnished by your office do not appear to show any activity by these offices. Please indicate, for each respective office, the number of open procurement fraud investigations involving major defense contractors. How many prosecutor reports have been submitted for prosecutive consideration? How many indictments and convictions have you obtained? When were these obtained? Are you satisfied with the results from Orlando and Dallas? What is your analysis of the problem?

Answer: DCIS Orlando has a total open case inventory of 21 cases. Eighteen of these cases include procurement fraud allegations. Five cases involve major defense contractors (Top 100 DoD contractors). Another DCIS field element has a pending investigation concerning a major defense contractor located in Florida. This case has been referred for prosecutive consideration to a Florida U.S. Attorney's Office. A total of 14 cases have been submitted for prosecutive consideration by the Orlando Resident Agency. Two individuals have been indicted and convicted through non-procurement fraud investigations by the Orlando Resident Agency. One conviction for procurement fraud was obtained in Florida by the Atlanta Field Office prior to the establishment of the Orlando Resident Agency.

The Dallas Field Office has 41 open investigations. Five of these cases involve major defense contractors. DCIS-Dallas has submitted 40 cases for prosecutive consideration. Eight individuals have been indicted or convicted as a result of Dallas' investigative efforts. The dates of these prosecutive actions were from February 1984 to September 1985.

I have seen some improvement in the prosecutive support we're receiving in these two locations. For example, the Dallas Field Office now has one prosecutor in the Northern Judicial District of Texas who is working full time or four of the cases against major defense contractors. The Defense Procurement Fraud Unit is providing prosecutive support on the last major case. These five investigations have been initiated since March 1984. The U.S. Attorney's Office has agreed to provide additional prosecutive resources on other DoD procurement fraud cases which are important, but do not include major defense contractors.

l: What is your largest single field office from the standpoint of investigative resources? How many prosecutor reports

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have been submitted for prosecutive consideration? How many indictments and convictions have you obtained against major defense contractors? When were these obtained? Are you satisfied with these results? What is your analysis of the problem?

Answer: The largest DCIS field office from the standpoint of investigative resources is New York (DCIS-NY). DCIS-NY has subelements located in Springfield, NJ, Hartford, CT, and Boston, MA. On September 20, 1985, the field office with its subordinate elements had an authorized strength of 30 special agents. Total open cases in inventory are 104. DCIS has presented 79 of these cases for prosecutive consideration. The prosecuting attorneys have requested DCIS participation in five cases under investigation by other Federal law enforcement agencies. The total number of criminal indictments and informations filed as a result of DCIS investigations is 51. The number of convictions now totals 29. The deterrent effect of their efforts is substantial. Additionally, the current case inventory includes 13 investigations concerning allegations of procurement fraud by major defense contractors.

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Question: The Subcommittee staff informed the Ethics Officer for the Office of the Secretary of Defense, in early March of this year, that DoD Assistant Secretary for Public Affairs, Michael Burch and other senior DoD officials, accepted gratuities from General Dynamics. Subsequent to that time, the Subcommittee staff briefed a criminal investigator from the Defense Criminal Investigative Service on this matter. On April 22, 1985, your office advised the Subcommittee staff that the Defense Criminal Investigative Service had opened an investigation into this matter. You testified that, during this seven-week period, your office had not been informed of the provision of illegal gratuities nor did the Secretary's office request action by your office on this matter.

a: Should the DoD's Ethics Officer have referred this information to the Inspector General?

Answer: The matter concerning whether or not a gratuity was provided by General Dynamics to Michael Burch, who was at that time the DoD Assistant Secretary for Public Affairs, was actually referred by your staff to the Assistant General Counsel (Legal Counsel) and not to the OSD Ethics Officer. Upon receipt of this allegation, the AGC conducted a preliminary inquiry. Mr. Burch indicated that he believed he had been invited by the Military Order of the Carabao Organization and, therefore, he was not receiving a gratuity from General Dynamics. He indicated he had correspondence which supported his understanding. Based upon the evidence, it was the legal opinion of the AGC that the matter did not warrant any further examination. Therefore, it was not referred to the Deputy Assistant Secretary for Administration, who also serves as the OSD Ethics Officer. The Assistant General Counsel believed that the matter had been brought to the attention of the IG's office, and she informed Mr. Burch at the time of her discussion with him that he should expect a call from the Defense Criminal Investigative Service.

Further guidance as to what constitutes a gratuity as well as the reporting responsibilities of DoD employees is needed and should be included in the next revision of the Department's Directive on Standards of Conduct. That directive is now undergoing revision and I have advised the Department of my interest and will be afforded an opportunity to comment during its development.

b: Does the Ethics Officer offer an explanation for not referring this matter to the Inspector General?

Answer: As previously mentioned, the information concerning Mr. Michael Burch was provided to the Assistant General Counsel (Legal Counsel), by the Subcommittee staff. The Assistant General Counsel (Legal Counsel) provides legal guidance and assistance to the Deputy Assistant Secretary of Defense (Administration) who is the designated "Ethics Officer." The AGC(LC) has advised us that, based upon her preliminary inquiry, the de minimis nature of the matter, and her belief that the IG's office had also received the information, the circumstances surrounding this specific incident did not warrant any further examination.

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☐	HOUSE SENATE	APPROPRIATIONS COMMITTEE	☐	HOUSE SENATE	ARMED SERVICES COMMITTEE	☒	HOUSE SENATE	OTHER Energy & Commerce
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Question: You testified that you performed a review in 1983 of the Defense Contract Audit Agency's reporting of contractor fraud. You stated that you found cases of untimely referrals, improper disclosures to procurement officials, failure to refer irregular conduct, and inadequate controls to assure timely referral. You further advised that your current followup review shows that DCAA has taken corrective action and shown major improvement in this area.

a. Please furnish copies of your 1983 and current reviews.

Answer: Copies of our two oversight reports on DCAA's reporting of fraud are enclosed (Tab 6).

(1) Report No. APO 85-016, dated August 27, 1985, "Followup Review of the Defense Contract Audit Agency's Reporting of Fraud or Illegal Acts."

(2) Report No. APO 84-4, dated March 9, 1984, "Oversight Review of the Defense Contract Audit Agency - Reporting of Fraud or Illegal Acts."

b. You indicated that fraud referrals by DCAA have risen nearly fivefold—increasing from 26 in fiscal year 1981 to 39 in 1982 to 60 in 1983 and to 125 in 1984. To what do you attribute this increase?

Answer: We attribute the increase in potential fraud referrals by DCAA to increased awareness and emphasis on the detection of fraud. The DCAA has made its auditors more aware of fraud through improved training, internal operating guidance and agency publications. The DCAA was tasked in mid-1983 by the DoD Comptroller to increase its emphasis on defective pricing, and to reexamine its procedures to identify indicators of fraud in defective pricing. In September 1983, DCAA issued guidance to its auditors on "Findings and Conditions in Postaward Audits that Require Further Pursuit as Potential Cases of Fraud." The DCAA has also conducted more reviews of labor costs which have resulted in increased referrals on labor mischarging. All of these actions have led to an increased number of referrals to DoD criminal investigative organizations.

My recent field visits indicate we are receiving excellent cooperation from DCAA.

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Question: You indicated that cost mischarging is one of your priorities. Describe why you have designated this type of violation as a priority.

Answer: Cost mischarging has been established as a major priority for two reasons: first, it results in large dollar losses to DoD and because it also has broad ramifications when committed by major contractors because it indicates serious deficiencies in their cost accounting and contracting systems.

a: Please identify the DoD cost mischarging investigations that have resulted in successful prosecutions since you became IG. List the contractors that are being investigated for cost mischarging and that have been referred for prosecution. How much money is involved?

b: How many were prosecuted by the: (1) Defense Procurement Fraud Unit; (2) Department of Justice Fraud Section; (3) U.S. Attorney?

Answer: The following cost mischarging cases have been sucessfully prosecuted since April 1983:

Contractor	Prosecutor
Davey Compressor Co.	DPFU
Reuben Garment International Inc.	U.S. Attorney
Silent Industries Inc.	U.S. Attorney
Sperry Univac Inc.	DPFU
American Electronics Laboratories	U.S. Attorney
Systems Architect Inc.	Fraud Section
Automation Services Inc.	Fraud Section
General Electric Co.	U.S. Attorney
Pace Development	U.S. Attorney
U.S. Crane Certification Bureau	U.S. Attorney
RDL Inc.	U.S. Attorney
Rocket Research	U.S. Attorney
Raycomm Inc.	U.S. Attorney
Stencil Aero Engineering	U.S. Attorney
Gould	DPFU
Systems Engineering & Technical Assoc.	U.S. Attorney

Currently there are over 130 open cost mischarging cases involving contractors under active investigation by DoD. The estimated loss from these cases is in excess of $200 million. (Prior to April 1983, our information indicates there were only 5 cost mischarging cases prosecuted.)

c: Have you identified in your "Semiannual Report to the Congress," the problems in securing prosecutive support in this area from the Department of Justice?

Answer: We have not raised this issue in the semiannual report. As I stated in my response to question 8.a., there are a number of factors contributing to the problem the resolution of which we are currently pursuing with the Department of Justice. We have testified on a number of occasions in support of the Program Fraud Civil Penalties Act and amendments to the Truth in Negotiations Act. Both of these are possible effective alterna-

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Question: You indicated that defective pricing is also one of your priorities. Please explain why you have designated this type of violation as a priority. Identify the DoD defective pricing investigations that have resulted in successful prosecutions since you became IG. List the contractors that have been referred for prosecution. How much money is involved?

Answer: Defective pricing has been established as a major priority because false cost and pricing data undermines the integrity of the procurement process and results in overstatement of contractor costs and overpayment by DoD. If we cannot rely on cost or pricing in contractors' bids and proposals, it becomes particularly difficult to do business with such contractors at all. Prior to our efforts in this area, criminal penalties were often ignored in favor of contractual actions under the Truth in Negotiations Act. We believe that this approach did not provide an adequate deterrent, especially since the amount of time devoted by DCAA to defective pricing reviews was less than 1% and the sustention rate on their findings was low.

To date, at least four cases have resulted in successful criminal prosecutions for defective pricing: Davey Compressor Co., RDL Inc., ATL Inc., and Jets/Allied Management. Both ATL and Jets/Allied were prosecuted under the Racketeering Influenced and Corrupt Organization Act. These cases resulted in criminal fines totalling over $13 million. Currently there are over 40 defective pricing investigations underway, involving possible loss to DoD in excess of $160 million.

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Question. You testified concerning your dissatisfaction with the lack of criminal prosecutions by the Department of Justice on cost mischarging and defective pricing cases. You said you "keep pounding them to the Procurement Fraud Unit" and that often the only thing you can do is to "make a lot of noise." You said you intended to go to Secretary Weinberger soon and that you were confident he would help out by signing letters in support of the IG program. Subsequent to your appearance before the Subcommittee, have you sought Secretary Weinberger's support in your effort to obtain better prosecutive support from the Department of Justice? If so, provide details.

Answer: Even before the Inspector General appearance before the Subcommittee on April 24, 1985, the Secretary of Defense had communicated one of his concerns to the Department of Justice regarding product substitution cases. (See letter at Tab 7.) Following the hearing, I elected to correspond directly with the Assistant Attorney General of the Criminal Division who is responsible for prosecutive support to DoD cases. (See letter at Tab 8.) Following this meeting, I have met with senior officials of the Department of Justice, including the Assistant Attorney General for the Criminal Division to emphasize our need for prosecutive support. My Assistant Inspector General for Criminal Investigations Policy and Oversight and my Assistant Inspector General for Investigations have had numerous similar meetings with representatives of the Fraud Section and the Defense Procurement Fraud Unit. I am satisfied that there are open communication channels between my office and the Department of Justice to ensure that our investigative priorities are known and understood by the Department of Justice.

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Question: You testified that you have hurt major contractors in the pocketbook. You provided as examples your recommendations that General Electric refund $168 million and that Pratt & Whitney refund $48 million.

a: Have you asked the Department of Justice to file civil actions to recover the money which you feel belongs to the Government?

b: Please provide full details on these two situations specifically, and on the lack of civil actions to recover such sums in general.

c: Can you furnish other examples of where the IG's efforts have hurt the major defense contractors in the pocketbook?

Answer: The $168 million and $48 million indicated in my statement in reference to the amounts we asked General Electric and Pratt & Whitney, respectively, to refund were the amounts reported in earlier versions of my audit report. The amounts were adjusted to $167 million and $38 million in the final audit report.

The Secretary of the Air Force asked for a voluntary refund of the money by General Electric and Pratt & Whitney. That request was refused by both contractors. General Electric's response ascribed most of the additional profit to improvements in efficiency. Consequently, in view of the indications of defective pricing, on August 1, 1985, we requested that the Defense Contract Audit Agency (DCAA) perform defective pricing audits of these contracts. DCAA agreed and is in the process of doing the audits now. Defective pricing appears to be an effective mechanism to adjust the contract price or profit when the contractor does not agree to voluntarily refund the money. After defective pricing is examined, further remedies will be explored.

Of the two followup audits to our Defense-wide audit of procurement of spare parts issued in May 1984, one addresses the 95 contractors identified as having sold unreasonably priced spare parts to Defense. We have completed work at 22 of the 95 contractors and have identified $52 million of defective pricing. We have impacted major contractors in their pocketbooks by tightening up the system in areas other than criminal investigations. For example, one of my other audits on the use of progress payments recommended that the maximum progress payment rate be reduced for large contractors from 90 percent to a prior level of 80 percent. Reducing the rate would reduce interest costs to the Government by about $230 million per year and would reduce fiscal year 1985 cash outlays by about $1.8 billion. That rate reduction was approved by the Secretary of Defense. We have also made a major increase in the number of defective pricing reviews conducted by DCAA and, most importantly, in the real dollars recovered from sustension of defective pricing audits.

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Question: You testified that you have written "a couple of letters trying to get (The U.S. Attorney in Miami) to move on (the Pratt & Whitney case)." Please provide copies of those letters and any other documentation available to your office concerning difficulties in securing timely prosecutive action by the Department of Justice in this matter.

Answer: My letter at Tab 8 reflects my concerns over the status of the Pratt and Whitney case. In addition, my Assistant Inspector General for Criminal Investigations Policy and Oversight has met with the Defense Procurement Fraud Unit to discuss the Pratt and Whitney case. The Chief of the Defense Procurement Fraud Unit has in turn addressed our concerns to the appropriate U.S. Attorney's Office.

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Question: You testified that you have written to Assistant Attorney General "Steve Trott and people like that" to get action by U.S. Attorneys on 28 cases including General Dynamics. Please provide copies of those letters and any responses from the Department of Justice. You also indicated that when this avenue is unsuccessful you have to seek prosecutive support by requesting the Secretary of Defense to write to the Attorney General. If you have requested that the Secretary support you in this manner, describe the situations and responses received. Include copies of relevant correspondence and supporting documentation.

Answer: A copy of my December 2, 1981 letter to the Department of Justice and the DOJ response regarding 21 cases is attached at Tab 9. I have also attached a copy of my letter regarding General Electric at Tab 10 which further illustrates my personal efforts to obtain prosecutive support from the Department of Justice. A copy regarding prosecutions in the Central District of California is at Tab 5. In addition, I have written a general letter to each U.S. Attorney requesting prosecutive support for DoD cases, and I have sent a letter to every U.S. Attorney where there is a DoD installation to advise the U.S. Attorney of the potential for DoD cases in his/her particular district (see Tab 11).

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Question: Your news release of September 26, 1984, advised that during the prior two and one-half years, DoD investigators had conducted 39,000 criminal investigations and that 17,000 had been referred for prosecution or administrative action resulting in 1,300 convictions. More recently, Deputy Defense Secretary William Taft, IV, testified before a House Armed Services Subcommittee hearing that, in the last three years, 20,000 contracting cases have been referred for prosecution or administrative actions, resulting in more than 1,500 convictions, some of which resulted in fines and long jail terms.

a. Are Mr. Taft's figures correct?

Answer: Mr. Taft's statement on March 14, 1985 that in the last three years 20,000 cases were referred for prosecution or administrative actions, resulting in more than 1,500 convictions, reflects the total investigative effort of the four Defense criminal investigative organizations and includes, in addition to those referrals of procurement fraud, such crimes as homicide, assault, and drug trafficking.

b. Please provide for the record, with regard to each of these figures, what percentage represents significant incidents or cases (as defined by DoD Instruction 5240.4).

Answer: Any attempt to correlate the number of reportable incidents with the figures provided would not result in a valid indication of significant investigative effort. The intent of DoD Instruction 5240.4 is to provide a system for notifying Office of the Secretary of Defense officials immediately of significant incidents regarding counterintelligence and criminal violations. This system should not be interpreted as an identification of all significant investigative effort being performed by the four Defense criminal investigative organizations in the areas of fraud, corruption and theft. Numerous investigations, such as those involving product substitution, corruption and theft, with an expected loss of less than $50,000, may not satisfy the criteria for reportable significant incidents, as defined by DoD Instruction 5240.4. However, due to the adverse impact on the morale and operational capabilities of the affected Departments, these investigations are mandatory and therefore significant.

c: Based on our review of the documentation which you have submitted to the Subcommittee, it would appear that the significant cases which you are investigating and prosecuting constitute a very small percentage of the figures furnished in your news release. Is it not true that the 39,000 investigations you referred to in your news release include such matters as:

— A serviceman filed a travel voucher for living quarters expenses. The travel office, identifying an overcharge, sent the voucher to the investigative agency, which found an overpayment of $18. The individual denied any intent to defraud the government while admitting that he had received excess reimbursement.

— An individual claimed excessive tips on his travel voucher. A travel section supervisor notified the investigative agency. The traveler admitted he had

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falsified his claim to receive maximum per diem. The amount overpaid was $46.

— A serviceman prepared fraudulent promotion orders, which caused his payment for unused leave to be made at a higher rate. He received an excess $222. Records management personnel uncovered the transaction and the offender was reprimanded.

— An employee was investigated for charging $26 in unauthorized long distance telephone calls. The employee was warned and $26 was recouped. In this case, other employees responsible for communications already knew the identity of the caller before the investigators were notified.

— A meat cutter at a commissary offered special butcher services during duty hours. Nothing indicated that he was paid by customers for the services. He was admonished, his personnel file was annotated, and other employees were warned not to engage in this practice. No money was lost.

— Theater cashiers bypassed internal control procedures and personally paid for shortages while not disclosing excess receipts from ticket sales. The Army-Air Force Exchange Service, which oversees the theaters initiated the investigation. Overages and shortages were about $5. Investigators found there was no intent to steal. Proper controls were reinstated.

Answer: We are trying to focus the Military Department's criminal investigative efforts on the significant cases. While past case inventories of the Defense criminal investigative organizations contain matters such as those reflected in your October 1, 1985 letter, the institution of increasingly more stringent selectivity factors and dollar thresholds has over the past year begun to focus the available investigative resources on more significant fraud related matters.

Alternatives to formal criminal investigations are being actively pursued on theft and fraud cases where losses are minimal. These alternatives include using uniformed military police, inspectors, and normal command personnel. In this way, the criminal investigator's caseload will be relieved of many small cases so efforts may be concentrated on higher loss cases.

d: With all the major crimes that are going uninvestigated, and billions of taxpayers' dollars being wasted, why is not a larger percentage of DoD's investigative resources being marshalled where it would do the American taxpayer the most good--that is, major theft and procurement frauds?

Answer: We do not agree that major crimes are going uninvestigated. The three military investigative organizations, in addition to the investigation of procurement fraud, have the responsibility for the investigation of violent crimes, such as homicide and assault as well as drug trafficking and sabotage, which have a significant adverse impact on the operational

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April 24, 1985				Quest. No. 17 Cont.

capabilities of the Military Departments. Two of these organizations are also responsible for another significant function — intelligence collection and the conduct of counterintelligence investigations.

In FY 1985, a study was conducted by the Office of the Inspector General, DoD, to estimate the number of fraud trained investigators required to meet the needs of DoD by the end of FY 1988. Using factors such as procurement dollars expended by individual DoD activities and geographic locations of primary procurement organizations, I or the OIG has recommended an increase of approximately 400 fraud trained investigators in DoD by FY 1988. We believe that if this increase is approved and funded in the Service budgets, an adequate number of DoD criminal investigators (approximately 1150) will be dedicated to significant fraud and theft cases.

e: Of the 3,629 DoD criminal investigators under your functional authority, how many were engaged in the investigation of similar minor matters? Conversely, how many of these investigators spent the majority of their time investigating significant procurement frauds?

Answer: Of the 3,787 DoD criminal investigators presently within the Department of Defense and over which I have oversight responsibility but not "functional" authority, 777 have been designated as fraud investigators. At any given time, each of these fraud investigators is responsible for several investigations which vary in significance during the life cycle of the specific investigative effort. While we are unable to provide the breakdown you requested, recent analyses indicates an upward trend in the number of investigations of Top 100 DoD contractors. This trend reflects the emphasis being placed on significant procurement fraud allegations.

Related to this trend is the increase in fraud referrals from the Defense Contract Audit Agency (DCAA). These referrals have grown over the past four years as follows:

YEAR ENDING 6/30	NO. OF REFERRALS
1982	39
1983	60
1984	134
1985	128

Since audit referrals are the primary source for accounting type frauds like cost mischarging, this increase is clearly a positive indicator. My office has worked closely with DCAA in enhancing its fraud reporting capability, including the development of a Memorandum of Understanding between DCAA and the DoD criminal investigative organizations.

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HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO	LINE NO	INSERT NO	Quest. No. 18

Question: In the July 12, 1984 issue of the Pittsburgh Press, in response to criticism for going after "nickel and dime" fraud cases while leaving the big defense contractors alone, you were quoted as saying that you expected criminal indictments in the fall of 1984, as a result of your investigations, of about 15 major corporations.

a: Please identify these 15 major corporations.

b. Please tell us what happened to those indictments.

c. In a speech on July 19, 1984, to the Procurement and Trade Conference in Indianapolis, Indiana, Secretary Weinberger stated that indictments of 15 "major" defense contractors were expected in the fall of 1984. What was the source of Secretary Weinberger's information?

d. Did he make this pronouncement based on your statement of several days earlier? Or was he referring to another 15 indictments that were anticipated?

e. Are enough investigators actually working your investigations to enable them to obtain adequate evidence and, where appropriate, refer the matter to the Department of Justice for prosecutive determinations and action, or are they merely opening more and more cases which never get fully investigated and resolved?

Answer: The article cited quotes me as saying that "a lot of them (investigations of major corporations) are in grand jury, and we expect we're going to see some...indictments starting around September. I think, looking at the cases we have, we've got at least 15 good, solid cases." The reporter misinterpreted me if he understood that I believed all 15 indictments were expected in the fall.

During the early part of 1984, I was intensively reviewing numerous significant investigations including those involving major corporations. My remarks in July 1984 reflected my expectations, based on those reviews, that criminal charges would be filed in the future on at least 15 of these cases. As the attached computer printout at Tab 12 reflects, 317 indictments were obtained from investigations conducted by the Defense Criminal Investigative Service from 1981 to 1985. Since July 1984, the DCIS indictment figure is 138. (These figures do not reflect indictments and convictions resulting from investigations conducted by the military criminal investigative organizations.)

Secretary Weinberger's prepared text in his speech to the Procurement and Trade Conference in Indianapolis, Indiana, on July 19, 1984, makes no mention of indictments of 15 "major" defense contractors. We have been unable to find any reference to it in the tape of his speech or in his meeting with the editorial board of the Indianapolis Star and News on that same date. You may be referring to an article in the New York Times of July 20, 1984, which was headlined, "Pentagon Chief Says Inquiries Will Send a Message to Contractors." While the Secretary made no mention of 15 indictments in the fall, the article did paraphrase comments I made anticipating indictments of 15 major contractors beginning in September 1984.

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As previously stated, recent analyses have identified the need for an additional 400 fraud investigators over the next three years to adequately respond to the anticipated investigative requirements of the four Defense criminal investigative organizations. Specific selectivity criteria and screening efforts are being incorporated into the case opening procedures to focus the limited fraud investigative resources on more significant fraud, corruption, and theft matters.

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April 24, 1985				Quest. No. 19

Question: You testified concerning global settlements where civil, criminal, and administrative problems are all wrapped into one settlement agreement between a contractor and the Government. These usually result in a decided advantage to the contractor and corresponding disadvantage to the Government. You clearly rejected this concept stating that "it's not...never was" the policy of the Inspector General. There appears to be some confusion because the Subcommittee was advised in a memorandum prepared by your Criminal Investigations Policy and Oversight Officer and dated April 16, 1985, that the DoD IG "actively supports global settlements."

a: Please provide the official IG policy regarding global settlements.

Answer: Although I do not support "global settlements," I do support the coordinated resolution of the criminal, civil and administrative actions which result from contract fraud cases. If handled properly, a coordinated resolution enables DoD to obtain a criminal conviction of all responsible parties, full civil restitution for funds lost through fraud, recovery of audit and investigation costs, and protection from unscrupulous contractors and contract officials. Furthermore, a coordinated resolution avoids the need to relitigate the same case in three separate forums—criminal, civil and administrative.

However, my office, as a general principle, opposes any settlement that does not include, at a minimum:

1. Criminal conviction of the contractor and all responsible corporate officials.
2. Full civil recovery for all appropriate damages and forfeitures under the civil False Claims Act.
3. Debarment of the contractor and all responsible individuals, unless the contractor demonstrates its present responsibility by:
   a. removing all corporate officials who were responsible for the fraudulent conduct;
   b. instituting internal controls which will preclude a repetition of the fraudulent conduct;
   c. instituting an internal program which informs contractor employees as to their responsibilities to adhere to proper conduct regarding DoD contracts; and
   d. providing DoD with unrestricted audit and inspection access to corporate records and premises in order to ensure that the reforms have been enacted and that present performance is in accordance with the law.
4. Further, my policy is not to support any settlement that waives the Government's right to prosecute for crimes we are unaware of at the time of the settlement.

The resolution of the criminal, civil and administrative aspects does not have to be in a single document. Contractors are

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free to seek separate agreements with DoD and DOJ. However DoD policy requires that DoD program managers coordinate contract fraud remedies with the DOJ. (See Tab 13, DoD Directive regarding Coordination of Remedies in Procurement Fraud Cases.)

b: Please provide copies of whatever guidance you have provided to the DoD criminal investigators, prosecutors, auditors, and other concerned parties, on this subject.

Answer: Attached at Tab 14 is the information regarding coordinated settlements which is provided by my office as part of the DoD Inspector General Contracting and Procurement Fraud Course.

c: Please summarize the problems you have found with global settlements, such as with the Sperry case. Have you experienced problems with other global settlement cases?

Answer: Sperry was an early attempt at a coordinated resolution, and was not adequate. The agreement was not properly staffed. It was not sent to the Office of Inspector General for coordination and it precluded subsequent prosecution of Sperry for certain alleged misconduct. The agreement not to prosecute should not have been a part of the settlement.

Subsequent coordinated resolutions have improved due to the gradual accumulation of experience in this area by DoD and DOJ. Currently our major problems arise from two situations:

- Often prosecutors conduct investigations exclusively using grand jury subpoenas. The protections afforded to grand jury material under Rule 6E, Federal Rules of Criminal Procedure generally preclude our use of the material for civil purposes. Thus, when a contractor offers to plead guilty and seeks an administrative settlement with DoD, we do not have sufficient facts outside of the grand jury which enable us to understand the factual terms of the case. Without these facts, DoD cannot assess the adequacy of the proposed reforms and corrective actions of the contractor. DoD therefore must conduct a second and independent fact-finding inquiry to determine all relevant facts.
- DoD suspension and debarment officials do not always assess the adequacy of contractor reforms in a timely manner.

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Question: With respect to your audits of the spare parts scandal, you testified that "we took an awful lot of punishment from everybody for doing that, from within the Department of Defense, from the contractors, and from everyone else."

a: Please explain what you meant by "we took an awful lot of punishment."

Answer: The criticisms did not come from the Secretary or Deputy Secretary of Defense who initiated and supported our efforts. However, some procurement officials in the Department of Defense believed the horror stories in the news media were isolated instances or were not significant or widespread. These officials were, therefore, opposed to our going any further, arguing that our efforts would show little return. Others believed our audit could not be done, that it simply was too massive an effort to be accomplished. We were frequently criticized for our audit at internal meetings including the Defense Council on Integrity and Management Improvement. Eventually, the doubters accepted that there was a problem that could be addressed and supported our audit. We were also criticized by many large contractors and some in the Trade press.

b: You testified that you found 95 contractors had overpriced parts to the DoD, that you have audits underway at these 95 contractors, and that you are referring defective pricing problems to your criminal investigators. Please provide a status report showing your findings to date. Please include the number of cases that have been referred for criminal investigation. Are any of these cases major defense contractors? Have you been successful in going for refunds in those instances where you cannot prove defective pricing but where the contractor's pricing is out of line?

Answer: My auditors have identified $52 million of defective pricing at 22 of the 95 contractors included in our audit. To date, we have referred 6 cases for criminal investigation. One of the 6 cases involves a major Defense contractor. Of the $52 million of defective pricing identified, only one report with $31,000 of defective pricing has been settled, but all of the other reports are being acted on by the contracting officers.

Although the Department has been successful at obtaining voluntary refunds in general, in these 22 audits we have no instances where we had to seek voluntary refunds because we could not prove defective pricing. (To date, we have made one defective pricing recovery as stated above.) The audit is not geared to compare a price a contractor charged for an item with another price for the same item that may be available from another source. We are auditing to determine if the 95 contractors are guilty of defective pricing or overpricing caused by noncompliance with Cost Accounting Standards.

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			Quest. No. 21

Question: The Cost Accounting Standards Board was disbanded about 4 years ago, after being in existence for many years. You testified that you have recommended that the CASB be reinstituted. Please explain why you made this recommendation.

Answer: The objectives of the Cost Accounting Standards Board (CASB) was to increase uniformity and consistency in cost accounting practices among Government contractors to improve the understanding and communication, reduce the incidents of disputes and disagreements, and facilitate equitable contract settlements. Since the CASB went out of existence, there has been no means to correct problems of equity and to protect the interests of the Government. Many changes to existing CAS policies are needed, such as adjustments to thresholds, changes in interest rates, interpretations of issued standards, and modifications of existing standards as a result of changed conditions. In addition, new standards may be needed to address changing conditions in the defense industry.

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Question: You mentioned that you did an audit of contracting officers and procurement officials and concluded that 67 percent of them were not well-trained and that the system was not training them. When was this audit performed? To whom did you report these findings? Describe the actions that have been taken to correct this serious problem.

Answer: That audit, "Report on the Audit of the Department of Defense Procurement Training," No. 84-047, copy at Tab 15, disclosed that of 1,5[illegible] training records of intermediate and senior level professional people examined at 24 different locations, 67 percent of these records showed that all mandatory courses had not been taken. We did not extrapolate this finding to the universe to conclude that 67 percent of all contracting officers and procurement officials were not well-trained.

The audit was made from June 1982 to November 1982 at the request of the Deputy Secretary of Defense. The findings were reported to the Assistant Secretary of Defense for Manpower, Installations and Logistics, the Under Secretary of Defense for Research and Engineering, the Secretaries of the Military Departments, and the Director, Defense Logistics Agency.

The various management responses to our final report concurred with the overall intent of our recommendations, which were to increase and improve training. The responses indicated that one lead office, the Defense Contracting and Acquisition Career Management Board, under the direction of the Office of the Under Secretary of Defense for Research and Engineering, should be tasked for coordinated implementation of the recommendations. After the audit, new program guidance was issued regarding mandatory training requirements. My Assistant Inspector General for Audit Followup is currently monitoring the full implementation of that guidance.

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April 24 1985				Quest. No. 23

Question: Subsequent to the April 24 hearing, you furnished additional information in which you advised that you agree that the kind of reviews proposed by Mr. Colin D. Parfitt in an April 5, 1985 memorandum are necessary. Mr. Parfitt, as was explained at the hearing, had faulted the IG's auditors for not performing constructive analysis and evaluation in connection with the IG's final report on the audits of aircraft engine spare parts pricing. You also advised that while such reviews are necessary, the question is how and when to do them.

a: Please describe specifically what you are going to do. When will your actions be accomplished?

b. What changes do you plan to make?

Answer: Mr. Parfitt has expressed a valid concept and one that I support. However, his criticism of the cited report is inappropriate because that audit dealt with costs already incurred. To achieve useful tools to fix contractor inefficiencies, the degree and cause of inefficiency must be determined prior to award of the contract.

I believe more attention by managers and the Defense Contract Audit Agency (DCAA) is needed to determine whether contractors are inefficient and the effect of contractor plant operations on a fully coordinated basis to identify uneconomical and inefficient practices in the contractor's management and operations. Much of this work can be done through "should cost" reviews. The short-term benefit of these reviews is a sound negotiating position for the Government for a specific contract. The long-term benefit is the achievement of a more efficient and economical contractor operation, which results in lower contract prices over the life of the acquisition program. Our audit of should cost efforts in the DoD showed that Defense has not yet established a standard approach for conducting should-cost analyses, and that should-cost studies are not performed on many programs where they appeared appropriate and to the extent expected by the Federal Acquisition Regulation. We are pushing for more of these studies to be done.

Also, my office, in coordination with the Office of the Assistant Secretary of Defense for Acquisition Management and at the direction of the Defense Council on Integrity and Management Improvement, is conducting a study comparing the use of work measurement techniques and standard hour estimates in the commercial and defense industries to help define future acquisition policy direction in this area. This study should be completed in April 1986. I believe that forcing more industrial engineering analyses of contractors' proposed direct labor as well as material, burden rates, and manufacturing processes, and then pricing those results out in DCAA reports, is the best approach to this issue on an institutionalized basis.

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HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO.	LINE NO.	INSERT NO.		Quest. No. 24

Question: You testified that there has been only one instance in which you found it necessary to seek enforcement of a subpoena by seeking the order of a United Stated District Court. You cited the Westinghouse Corporation as being the contractor involved. Please describe the circumstances surrounding this matter and provide the current status. Have you experienced any other instances where Westinghouse has not cooperated with the IG in a proper manner?

Answer: Attached at Tab 16 is a copy of the U.S. District Court opinion which contains the full history of the Westinghouse case. The court ordered Westinghouse to comply with the subpoena. The District Court's order has been stayed, pending the appeal by Westinghouse to the 3rd Circuit Court of Appeals. We have no other reported instances of non-cooperation by Westinghouse which have required the issuance of a subpoena by the DoD Inspector General.

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

TAB 2

2 MAY 1985

MEMORANDUM FOR SECRETARY OF DEFENSE

SUBJECT: Recommendation for the Consideration of Suspension in Connection with Actions by General Dynamics Corporation Executives--INFORMATION MEMORANDUM

Attached for your information is a copy of my memorandum to the Secretary of the Navy regarding the actions of certain officers of General Dynamics.

Joe Sherick
Joseph H. Sherick
Inspector General

Enclosure

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

2 MAY 1985

MEMORANDUM FOR SECRETARY OF THE NAVY

SUBJECT: Recommendation for the Consideration of Suspension in Connection with Actions by General Dynamics Corporation Executives

This is to recommend that immediate consideration be given by the Navy, pursuant to the provisions of Subpart 9.4 of the Federal Acquisition Regulation, to a suspension based on improper, and possibly illegal, conduct by three high level officials of the General Dynamics Corporation. The three officials are: Messrs. David S. Lewis, Chairman of the Board, Gordon E. MacDonald, Executive Vice President and Chief Financial Officer, and George Sawyer, Executive Vice President for Land Systems. This recommendation is based on my belief that adequate evidence exists to demonstrate that Messrs. Lewis, MacDonald and Sawyer lack the business integrity and honesty required of high level officials in corporations that do business with the Government.

Information on which I have based my recommendation is contained in three documents:

1. Transcript of hearing before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives, on February 28, 1985 (Enclosure 1);

2. Naval Investigative Service (NIS) Report of Investigation, dated December 20, 1984 (Enclosure 2); and

3. Transcript of hearing before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives, on March 25, 1985 (Enclosure 3).

These documents indicate that Messrs. Lewis, MacDonald and Sawyer have engaged in activities which demonstrate a lack of business integrity and honesty. The activities are summarized as follows:

1. Enclosure 1 contains evidence that indicates that Messrs. Lewis and MacDonald were personally involved in a decision to issue a press release which falsely stated that the first Trident submarine would be delivered in October 1979, when

in fact they knew at the time that it could not be delivered before the end of 1980. The false press release was issued to halt a decline in the value of General Dynamics stock. This may be a violation of 15 U.S.C. 77 q(a) and 15 U.S.C. 78 j(b), of Federal security laws which cover stock manipulation, as well as the requirement for corporate officers to provide full and fair disclosure of information to stockholders and investors.

2. Enclosures 1 and 2 contain evidence which indicates that Mr. MacDonald admitted to directing a General Dynamics employee to purchase two pieces of jewelry, having a value of approximately $1,125, for Admiral Rickover's wife. In addition, there is evidence that Mr. MacDonald discussed the proposed gifts with Mr. Lewis prior to ordering their purchase and delivery. This may have been a violation of 18 U.S.C. 201 concerning gratuities and 10 U.S.C. 2207 which prohibits the provision of gratuities on Government contracts.

3. Enclosure 3 contains facts showing that from March through May 1983, Messrs. Lewis, MacDonald and Sawyer engaged in negotiations concerning the potential employment of Mr. Sawyer. These negotiations occurred while Mr. Sawyer, who was at the time Assistant Secretary of the Navy for Shipbuilding and Logistics, had the authority to and did make decisions affecting General Dynamics. This may be a violation of 18 U.S.C. 207 and 208 concerning conflicts of interest.

4. Enclosure 3 also contains evidence that Mr. Sawyer stated to Navy officials that he had not negotiated for employment with General Dynamics prior to May 20, 1983, when in fact he had begun discussions with General Dynamics regarding employment possibilities as early as March 1983. For example, on March 25, 1983 and May 18, 1983, he traveled to Saint Louis, Missouri, and Chicago, Illinois, respectively, for the purpose of discussing employment possibilities with General Dynamics. These trips were paid for by General Dynamics. This may be a violation of 18 U.S.C. 1001 concerning false statements.

Each of these instances may involve criminal conduct, and clearly raise questions as to the responsibility of Messrs. Lewis, MacDonald and Sawyer as Government contractors. Subpart 9.407-2 of the Federal Acquisition Regulation states that a suspending official may suspend a person based upon adequate evidence of the commission of an offense indicating a lack of business integrity and business honesty that seriously and directly affects the present responsibility of a contractor. In my opinion, adequate evidence of such offenses is present.

Each of the four instances set forth above is under active review by a number of agencies. The first instance regarding manipulation of inside information is the subject of an investigation by the Securities and Exchange Commission and a

Federal grand jury. The second instance relating to gratuities to Admiral Rickover is the subject of a hearing by the Navy Gratuities Board. The Department of Justice is also considering civil action against all parties concerned. The third and fourth instances involving Mr. Sawyer's employment negotiations with General Dynamics are also the subject of a grand jury investigation. The prosecutor in charge of the grand jury investigation has requested that any proposed suspension action in this case be discussed with the Department of Justice, prior to the provision of any formal notice to Messrs. Lewis, MacDonald and Sawyer.

Please be advised that this recommendation is based upon my review of the evidence, as the Inspector General, Department of Defense. I am aware that the Suspension and Debarment Authority of the Navy is required, under Subpart 9.4 of the Federal Acquisition Regulation, to consider a broad range of factors in determining what, if any, action may be appropriate to protect the interest of the Government. If I may provide any further information or advise in this matter, please do not hesitate to contact me or Mr. Michael C. Eberhardt, Assistant Inspector General for Criminal Investigations Policy and Oversight, Office of the Inspector General, DoD, at 694-1234.

Joseph H. Sherick
Inspector General

Enclosures

DEPARTMENT OF DEFENSE
OFFICE OF THE INSPECTOR GENERAL
WASHINGTON, D.C. 20301

TAB 3

24 JUL 1985

MEMORANDUM FOR COMMANDER, ARMY CRIMINAL INVESTIGATION COMMAND
DIRECTOR, NAVAL INVESTIGATIVE SERVICE
COMMANDER, AIR FORCE OFFICE OF SPECIAL INVESTIGATIONS
DIRECTOR, DEFENSE CRIMINAL INVESTIGATIVE SERVICE

SUBJECT: Review of DoD Criminal Investigative Initiative Operations

On May 30, 1983, my office issued a report covering Phase I of an oversight project which reviewed DoD Criminal Investigative Initiative Operations. On June 4, 1984, the report covering Phase II of that project was disseminated. Both reports included general and specific recommendations for the Defense criminal investigative organizations, and requested comments from each organization. The recommenations and comments have been collated at Tabs A and B. All comments have been evaluated and where appropriate, responses from this office have been included. The absence of responses to many of the comments indicates general concurrence with those particular issues.

Phase I emphasized the requirement for concentration of Fraud and Crime Prevention Survey efforts in the high dollar procurement arena. Further, it highlighted the necessity for using survey reports to document weaknesses and insure that military commanders respond to the comments and recommendations in survey reports.

The thrust of the recommendations in Phase II concerned maintenance of an aggressive initiative posture by all Defense criminal investigative organizations. Effective initiative operations are only as good as the quality of source management. Sound source and initiative operations management requires timely review by senior organizational personnel as emphasized in guidelines published by the Attorney General.

This office will incorporate the results of this project and the Attorney General's guidelines into policy guidance for the use of sources and undercover operations in the Department of Defense.

Michael C. Eberhardt
Assistant Inspector General for
Ciminal Investigations Policy and Oversight

Enclosures

Review of DoD Criminal Investigative Initiative Operations

PHASE I

Recommendations and Comments

1. The investigative organizations should utilize multidiscipline teams led by a qualified special agent when conducting fraud prevention surveys for elements of the Defense Logistics Agency (DLA).

A. All Defense criminal investigative organizations (DCIO) concur.

2. In appropriate circumstances, the investigative organizations should consider increased use of system/function-oriented fraud prevention surveys focused on a particular problem versus a full-scope, entire operation.

A. All DCIOs concur.

3. The investigative organizations should actively participate in the selection of fraud survey targets and emphasize known or suspected fraud indicators as a basis for target selection.

A. Army Comment: Concur. Previously participated in selection of DLA targets. Continues to select Army survey targeting.

B. Navy Comment: Concur. Prior to IG, DoD review, NIS was planning revised actions.

C. Air Force Comment: Concur. AFOSI will continue to negotiate selection of survey targets emphasizing those with potential problems.

D. Defense Criminal Investigative Service (DCIS) Comment: Concur. Field elements do actively participate.

4. Navy and DCIS should conduct presurvey liaison with appropriate local law enforcement, legal, financial and contract administration disciplines as well as equivalent counterpart Federal Agencies.

A. Navy Comment: Concur. However, only in those surveys where they are routinely scheduled and announced.

B. DCIS Comment: Concur. Presurvey liaison is conducted.

5. Investigative organizations should routinely publish some type of fraud alert/indicators notice which could be utilized to alert appropriate commanders and program managers to specific fraud threats or potential for extensive fraud.

A. All DCIOs concur.

6. Army and Navy should increase the number of agents assigned in the Washington, DC, area to provide increased proactive support to major commands susceptible to large dollar fraud and economic crime.

A. Army Comment: Concur. Subject of ongoing analysis.

B. Navy Comment: Concur. Washington fraud squad being expanded.

7. Investigative organizations should include integrity and bribery offenses in future "Fraud Indicators" publications.

A. All DCIOs concur.

Specific Recommendations for each DCIO

DCIS

1. DCIS should ensure greater coordination with its audit counterpart in the IG office to ensure proper input in planning and conducting surveys.

A. DCIS Comment: Agree. System is in place for coordination.

2. DCIS should routinely review those Defense Contract Audit Agency (DCAA) audit reports which involve contractor actions that may be indicative of intentional criminal conduct.

A. DCIS Comment: Agree. This organization has continuous contact with DCAA. Any contracts indicative of criminal wrongdoing are referred to us for review on a routine basis.

ARMY

1. The large amount of effort USACIDC devotes to crime prevention surveys of installation activities of relatively low value...should be balanced against increased proactive effort

in developing substantive fraud investigations in high dollar contract and procurement programs and logistical facilities by employment of traditional investigative methods.

A. Army Comment: Generally concur. However, ... the Crime Prevention Survey Program (CPSP) has proven to be effective in identifying potential crime... and reducing crime rates. A decrease in the number of surveys may be perceived as a degradation of support... and could lead to increases in crime rates...

B. Inspector General, Department of Defense (IG, DoD) response: Increased proactive effort in the high dollar, procurement fraud arena must receive top priority. Commanders should be advised that any decrease in the traditional CPSP should not be perceived as a degradation of support. Support for low dollar surveys can still be provided where absolutely required.

2. USACIDC should consolidate the substantive deficiencies/recommendations of the extensive crime prevention surveys... which are common at most posts and issue one encompassing report rather than continually conducting surveys of the same target at similar geographical locations.

A. Army Comment: Concur generally, however see comments at number one above.

B. IG, DoD Response: See response at number one above.

3. The "Crime Prevention Activities" section of the USACIDC Crime Prevention Report should focus increased emphasis on the areas assessed as most vulnerable in the Army: computers, acquisition, property disposal, depot operations, inventory and transportation.

A. Army Comment: Concur. Increased emphasis will be placed on these areas.

NAVY

1. NIS should increase specialized fraud training for special agents.

A. Navy Comment: Concur. An aggressive specialized training program commenced in FY 1984.

2. NIS should provide to U.S. Marine Corps procurement and logistics commands service equivalent to that provided to the Navy systems commands in the area of fraud prevention surveys.

A. Navy Comment: Concur. NIS will initiate discussion with appropriate Headquarters, U.S. Marine Corps officials to develop a program as recommended.

3. NIS field elements should receive copies of all Naval Audit Service reports of naval activities within their geographical area of responsibility.

A. Navy Comment: Nonconcur. Routine review of all such reports by field components has questionable utility in planning initiative operations or identifying potential fraud indicators when viewed in light of current procedures. Those procedures ensure timely reporting of potential fraud or other criminal activity developed during an audit far in advance of the publication of the audit report...

B. IG, DoD Response: The procedures outlined above appear to partially satisfy the intent of this recommendation. Nonetheless, NIS field elements must be provided copies of Naval Audit Service (NAS) reports whenever a resource loss or a systemic indicator of a fraud conducive environemnt is identified.

4. NIS should implement at the earliest practical time the two modifications described in Section E, paragraphs 3, 4 and 5. (i.e., (a) selection of targets for crime prevention surveys based on NIS field element input with presurvey coordination limited to only senior program officials and (b) encompassing the management benefits of crime prevention surveys into all phases of NIS Initiative Operations.)

A. Navy Comment: Concur. Modifications are being implemented.

5. NIS should receive a command response to recommendations made in survey reports.

A. Navy Comment: Concur if the intent is for NIS to utilize the information as a possible alert to fraud indicators or to assess the NIS product. Nonconur if the intent is to place NIS in an oversight role for actions taken or not taken as a result of recommendations made in survey reports. Such oversight responsibility is a management function which appropriately resides in the chain of command for activities at which surveys are conducted.

B. IG, DoD Response: The intent of this recommendation is to provide NIS future utilization and target vulnerability assessment capability of the information, not to place NIS in an oversight role.

AIR FORCE

1. In order to improve the potential effectiveness of target analyses, AFOSI agents should establish prior coordination/liaison with local representatives of the Air Force Audit Agency, USAF Inspector General and Security Police.

A. Air Force Comment: Partially concur. AFOSI regulations emphasize the importance of coordinating with auditors, inspectors and other base officials. It should be noted, however, that the primary purpose for target analyses is for AFOSI to gather information for internal use. As such, coordination of target analyses is sometimes not documented. Nevertheless, target analyses can, and sometimes does result in other investigative efforts which require liaison contact. AFOSI will send a policy letter to field units addressing the need for coordination.

B. IG, DoD Response: Concur. The use of target analyses as a predicate for proactive effort is a sound approach.

2. In order to increase the overall benefit of the effort devoted to conducting target analyses, AFOSI should provide a copy of the report to the affected commander.

A. Air Force Comment: Partially concur. An important point to remember about AFOSI target analysis is that most data gathered is background information on the target. This information is solely for the benefit of the AFOSI field element and is known or available to the responsible commander. When significant weaknesses are disclosed, these are reported orally or via an Investigative Report or Fraud Awareness Report, as appropriate.

B. IG, DoD Response: Concur, however, all "significant weaknesses" must be documented by a written report.

3. AFOSI should emphasize commands/facilities with a potential for developing high dollar investigations in conducting future target analyses.

A. Air Force Comment: Concur. This is a command goal.

4. AFOSI survey reports should contain appropriate recommendations for corrective action to cited deficiencies.

A. Air Force Comment: Concur. AFOSI will make appropriate regulatory changes.

5. AFOSI should emphasize commands/facilities with a potential for developing high dollar investigations in conducting future fraud prevention surveys.

A. Air Force Comment: Concur. This is a command goal.

6. AFOSI should selectively distribute Fraud Information Reports to concerned local commanders and program managers who can implement corrective measures. Similar distribution should be made of sanitized versions of Fraud Briefs, absent sensitive investigative methods or suggested detection techniques.

A. Air Force Comment: Concur. AFOSI headquarters will instruct field offices concerning which reports should be distributed at local commands.

Review of DoD Criminal Investigative
Initiative Operations
PHASE II

RECOMMENDATIONS FOR DoD CRIMINAL INVESTIGATIVE ORGANIZATIONS

1. Establish procedures for the management and control of undercover operations and use of informants and confidential sources that incorporate the substance of the Attorney General's guidelines on these activities. (The Inspector General, Department of Defense, will issue policy guidance on this subject.)

A. Army Comment: It is USACIDC's opinion that current policies contained in command directives and regulations do provide adequate procedures for the management and control of undercover operations and use of sources. Some discrepancy exists between the Attorney General/FBI's definition of an informant and a confidential source in contrast to USACIDC's definition. The Attorney General guidelines address only those sources who are targeted and controlled by the agent whereas the USACIDC regulation not only addresses sources targeted and controlled, but also the one-time or infrequent source who is not targeted or controlled by the agent. With these differences noted, it is believed USACIDC does follow the intent of the Attorney General's guidelines. Pending the issuance of policy guidance on these subjects as noted in the recommendation, the USACIDC intends to maintain current operational procedures in these functional areas.

B. Navy Comment: Concur. A forthcoming revision of the Naval Investigative Service Manual for Investigations addressing the conduct of undercover operations and use of confidential sources provides substantive instruction regarding the Attorney General's guidelines on these activities. Additionally, a copy of the Attorney General's guidelines will be incorporated as an appendix to the manual.

C. Air Force Comment: We agree with the Attorney General's guidelines on the use of informants which covers the informant himself, i.e., he is told he is not an agent and he is liable for any criminal acts he should indulge in. These principles have been followed by AFOSI for many years. However, we cannot support the requirement for annual headquarters review or the 90 day supervisory review. Such review is a constant process at the field level and a semiannual one by the district source manager; we feel this review process is more than adequate. We agree in principle with the Attorney General's guidelines on undercover operations; however, we wish to reserve further comment until we have the opportunity to review the policy guidance on this subject, to be issued by the Inspector General, Department of Defense.

D. DCIS Comment: Concur.

E. IG, DoD response: The substance of the Attorney General's guidelines include the provision for appropriate senior management review and assign the responsibility to headquarters elements to approve and oversee all sensitive activities conducted by field units. Policy guidance on this very critical subject will include the requirement for headquarters oversight of source and undercover operation programs.

2. Ensure that all professional personnel are familiar with the Attorney General's guidelines on undercover operations and use of informants and confidential sources.

A. Army Comment: Upon completion of action as noted in recommendation one, USACIDC will emphasize and comply with the resulting DoD policy for implementation of the Attorney General's guidelines for undercover operations and use of sources.

B. Navy Comment: Concur. Instruction regarding the Attorney General's guidelines on undercover operations and use of informants and confidential sources will be incorporated into the syllabus of our basic agents training and addressed in our advanced criminal investigators' seminar. Upon publication of the manual change, addressed supra, field components will be directed to address the content of the Attorney General's guidelines during scheduled in-service training.

C. Air Force Comment: AFOSI will attach the Attorney General's guidelines on undercover operations to AFOSIR 124-68, Undercover Operations, to be used as a guide for AFOSI district commanders who would maintain approval authority for most undercover operations. Since the Attorney General's guidelines on informants and confidential sources are not entirely applicable to AFOSI, it would only cause confusion to send them to the field as they now read.

D. DCIS Comment: Concur.

3. Increase initiative efforts targeting high dollar procurement fraud, particularly those involving product substitution, cost mischarging and defective pricing.

A. Army Comment: Concur. Initiative efforts targeted in this area are resource intensive. In this regard, the USACIDC has requested additional manpower requirmeents necessary to support programs to prevent, detect and investigate fraud, waste and abuse. An out of cycle manpower request for these additional resources was forwarded to Department of the Army in March 1984. These additional personnel are key to improvements in our economic crime program. Additionally, the USACIDC has initiated a regulatory change in investigative jurisdiction from the USACIDC to area/installation provost marshals for certain type cases. This change will enable the USACIDC to dedicate additional resources to the detection and investigation of economic crime. The USACIDC will continue to increase its efforts targeted at high dollar procurement fraud through the continuous refinement of the Economic Crime Investigator Specialty Program, the publishing of the Worldwide Economic Crime Threat Assessment and implementation of the Longitudinal Survey Program. As indicated below, USACIDC will continue to emphasize the recruitment of sources and the expenditure of .0015 funds targeting economic crime.

B. Navy Comment: Concur. The Naval Investigative Service has made a concerted effort to increase our initiative operations targeting high value procurement fraud. Several sensitive undercover operations directed against depredations in the procurement arena are currently ongoing and numerous tentative operational scenarios are under review by the Naval Investigative Service Headquarters. Joint operations are also being conducted with the DCIS in the area of product substitution and cost mischarging.

C. Air Force Comment: AFOSI has undertaken several initiatives to target high dollar acquisitions. For example, in November 1983, AFOSI initiated Project Seven Pros to give better investigative support to Air Force Plant Representative Offices (AFPROS) at various contractor facilities throughout the United States. The primary purpose of Seven Pros is to detect fraud in central acquisitions. Another AFOSI initiative is collection of fraud information concerning contractors with Base Operating Maintenance contracts, under Project Seven Booms. Both Seven Pros and Seven Booms have been successful. AFOSI has also deemphasized low dollar cases, such as travel voucher frauds, and encouraged local commanders to investigate those matters on their own.

D. DCIS Comment: Concur.

4. Increase efforts to recruit confidential sources capable of providing information leading to substantive procurement fraud investigations.

A. Army Comment: Concur. The USACIDC will continue in its efforts to recruit sources capable of providing information leading to substantive procurement fraud investigations. The need for continued emphasis in this area was expressed by the Commanding General, USACIDC at the last Commanders and Staff Conference and will continue at all levels. The results will be items of interest during USACIDC Inspector General inspections, region assistance team visits, command staff assistance visits and will be managed at headquarters through the quarterly Review and Analysis.

B. Navy Comment: Concur. The importance of recruiting reliable confidential sources in the area of white collar crime has been stressed to the agent corps. A pilot program soliciting the assistance of contractors and vendors conducting business with the Departmnt of the Navy has been initiated at two field components. If effective, this initiative program could have a significant effect on future operations targeting fraud, waste and abuse in the naval services.

C. Air Force Comment: AFOSI has already improved its recruitment of confidential sources to provide information on procurement fraud. Under Project Seven Pros approximately 25 new sources were recruited during the period January through April 1984. Also, recruitment of sources is a major theme of our Undercover Agent Course which is being given at all AFOSI districts.

D. DCIS Comment: Concur.

5. Ensure that sufficient confidential contingency funds are available to support increased initiative efforts targeted at white collar crime and that orqanizational policies and procedures do not inhibit prudent exenditures of these funds in appropriate circumstances.

A. Army Comment: Concur. Sufficient confidential contingency funds are available to support efforts targeted at white collar crime. Current policy does not prohibit expenditure of these funds. Use of .0015 funds for white collar crime will continue to be emphasized at all levels.

B. Navy Comment: Concur. Comprehensive organizational policy exists regarding the utilization of confidential funds. To date, confidential funds have been adequate to support ongoing initiative operations. Targeting white collar crime will require timely assessment of confidential funds available to support operational activity and could necessitate a request for increased funding during fiscal year 1985.

C. Air Force Comment: Sufficient funds are available for increased initiative efforts in targeting white collar crime. Because of the changing emphasis in crime targeting, the correlating expenditures must also change with the flow. Although sometimes it may appear that the directives indicate otherwise, these same directives must be flexible to apply to a variety of cases. We have been supportive in authorizing expenditure of funds in circumstances not explicitly provided for in the directives. Organizational policies do need to be proactive. Nonetheless, prudent expenditures must be within the Government's generally accepted standards.

D. DCIS Comment: Concur.

6. Identify, assess potential vulnerbility, and prioritize high dollar DoD procurement activities, and apply commensurate investigative resources. At large DoD supply and procurement complexes, as well as other facilities considered appropriate, establish dedicated white collar crime teams consisting of specially trained and experienced agents whose primary responsibilities are development and pursuit of fraud investigations through initiative efforts.

A. Army Comment: By use of the Economic Crime Threat Assessment (ECTA), the USACIDC does identify and prioritize high dollar DoD procurement activities vulnerable to economic crime. Efforts and personnel are tailored commensurate with the ECTA and other USACIDC investigative mission requirements. To acquire sufficient personnel to meet the total economic crime threat, USACIDC has submitted an out-of-cycle manpower request to the Department of the Army. Future manpower assets resulting from this request may enable USACIDC to establish dedicated white collar crime teams to large DoD supply and procurement complexes.

B. Navy Comment: Concur. The Naval Investigative Service, based on an assessment of potential vulnerabilities, has established white collar crime task forces at Naval Supply Center (NSC), Norfolk, Virginia, and Charleston Naval Base, Charleston, South Carolina. The efforts of these task forces have been highly productive and consideration is currently being given to the establishment of a similar task force at the Brooklyn Navy Yard, Brooklyn, New York. It is anticipated that the increase in the number of dedicated fraud agents and the intensive fraud training program embarked upon by the Naval Investigative Service will facilitate the establishment of white collar crime task forces in the future.

C. Air Force Comment: AFOSI has identified its priority fraud targets many times. The primary targets are the Air Force Logistics Centers, AFPROS, and Air Force Systems Command product centers. The AFOSI has instituted a fraud coding system to identify the fraud investigative needs of every AFOSI unit, developed a comprehensive program to generate well-trained agents, and manned each detachment, to the best of their ability, with the types of trained agents needed. AFOSI has asked for 52 manpower slots in the POM for the years 1986-1988 to put dedicated fraud investigators at the major bases which serve central and systems acquisitions bases. These were identified in AFOSI's strategic fraud plan which outlines the AFOSI fraud program through 1994.

D. DCIS Comment: Concur.

7. Establish a program within each DoD criminal investigative organization for the collection and analysis (and exchange, where appropriate) of criminal intelligence pertaining to possible fraud and corruption within the DoD. This program would facilitate the issuance of trend reports and provide assistance in the planning process for initiative investigations. This recommendation incorporates an objective of the President's Council on Integrity and Efficiency pertaining to increased emphasis on prevention activities such as reporting possible vulnerabilities in programs and systems, as they are disclosed in criminal investigations.

A. Army Comment. The USACIDC has an established program for the collection of criminal information pertaining to fraud and corruption as well as other criminal activities. This headquarters does not have a dedicated team of analysts. We do, however, conduct a semblance of analyses by a review of various investigative reports to either detect program vulnerabilities or target programs for review. At present, these analyses do not normally result in formalized crime trends or patterns. However, a current Operations Directorate internal reorganization resulted in creating a branch which will perform this analysis function. It is anticipated this branch will be functional on or about October 1, 1984.

B. Navy Comment: Concur. The Naval Investigative Service's initiative operations in the area of fraud are designed not only to identify criminality, but to rectify possible vulnerabilities in programs and systems. Operations to date have been successful in identifying areas of vulnerability caused by administrative anomalies and security weaknesses and shortcomings in these have been brought to the attention of the requester for possible correction and improvement. A criminal analyst has been employed to assist in the production of trend analysis and a computer fraud expert will be hired in the immediate future to further enhance the ability of the Naval Investigative Service to identify vulnerabilities in the area of white collar crime. Liaison has been effected with counterparts of USACIDC and AFOSI and it will be proposed that meetings take place on a regularly scheduled basis to discuss mutual problems in the area of fraud. Currently, a joint undercover operation targeting fraud within the Air Force and Navy procurement systems in the Virginia area is ongoing.

C. Air Force Comment: AFOSI currently has two systems, CR 53 and the case survey system, to analyze fraud trends. Another system, CACTIS, will be instituted in the future and certain portions of it are already being tested. AFOSI does issue trend reports (AFOSI Annual Summary of Investigations), special reports, and other analytical products. AFOSI has issued several analytical products at the request of specific Air Force officials. For example, they have analyzed pay allowance cases, fraud in supply activities, cash register manipulations, and fraud in disposal activities. These products are used by the Air Force community to modify or institute procedures.

D. DCIS Comment: Concur.

8. Increase the interface of military investigative organizations with local representatives of the United States Attorney's Office, particularly field agents whose primary responsibilities are economic crime investigations. Adherence to the thrust of the Attorney General's Guidelines coupled with expanded relations with the Federal prosecutor should result in improved remedies in all areas of economic crime investigations.

A. Army Comment: Concur. The USACIDC has made and will continue to make a major effort to increase the interface with local representatives of the United States Attorney's Office. When they are in operation, USACIDC ECISP Level I Agents have participated in the DOJ Regional Economic Crime Enforcement Centers. Also, USACIDC has increased its interface with military commanders and contracting officers by participation on installation crime prevention councils and development of fraud awareness training for those councils. We have initiated and/or supported such programs as DOJ's Law Enforcement Coordination Councils and the Defense Procurement

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Fraud Unit, and established ever increasing routine liaison by field agents with AUSAs, commanders, staff judge advocates and contracting officers.

B. Navy Comment: Concur. As a result of several joint undercover operations and the establishment of the aforementioned fraud task forces, interface between special agents of the Naval Investigative Service and local representative of the United States Attorney's Office has increased dramatically. It is expected that contacts will continue to increase based on projected additional initiative efforts in the fraud area. Additionally, procedural guidance eminating from the Naval Investigative Service Headquarters has identified the beneficial capabilities that can be provided by the United States Attorney's Office, and encouraged all special agents in charge to effect meaningful liaison regarding matters of mutual concern.

C. Air Force Comment: AFOSI has tried numerous tactics to improve and expand relations with U.S. Attorneys. For example, in 1982 each AFOSI unit was tasked to coordinate with their local U.S. Attorney (USA) and become a member of their Law Enforcement Coordinating Committee (LECC). The purpose of joining the LECC was ultimately to improve the USA's prosecution of AFOSI fraud cases. AFOSI directives, such as AFOSIR 124-5, Fraud Investigations Manual, have extensive discussions on the desirability of face to face contact with the local USA. Unfortunately, this has not been a two way street. The USA must also agree to direct contact with military investigators. In some cases, USA's prefer to route the military investigator through the local FBI. While AFOSI does not agree with that procedure, it is sanctioned by the current DoD/DOJ MOU.

D. DCIS Comment: Concur.

Specific Recommendations for each Defense Criminal Investigative Organization

Army

1. Establish a system for periodic reporting of the productivity and expenses of all registered sources to United States Army Criminal Investigation Command (USACIDC) Headquarters.

A. Army Comment: The current USACIDC system of reviews conducted by local agent supervisors, field element commanders, region assistance teams, headquarters Inspector General inspections, and Resource Management Directorate internal reviews insures that periodic reviews are made of registered source productivity and expenses. Also, the quarterly Review and Analysis Report contains this registered source data and is disseminated at all investigative levels for review and evaluation. The USACIDC is aware that a reevaluation of methods to judge the productivity of sources is needed. However, initial reaction to the suggestion that this headquarters receive productivity documentation on all registered sources is that it would be an extremely burdensome requirement. This issue will be considered in our assessment. The future implementation of the CID Operational and Management Information System (CIDOMIS) will provide HQUSACIDC with an automated mechanism to capture registered source productivity and expense data which is currently acquired manually. The methodology as to how the centralized information could be utilized to enhance or improve the source program will also be evaluated.

B. IG, DoD Response: Local and regional review and periodic headquarters inspections provide an essential element to source system oversight. Nevertheless, a comprehensive oversight program can only be provided if the headquarters element maintains a current file reflecting the status, productivity and particular problems associated with each source. The intent of this recommendation is not to suggest that "control" of the source be exercised by the headquarters. Rather, accessibility to a current headquarters file provides the ready and immediate capability to react quickly if problems arise or to suggest remedies for less productive sources. This should not be a particularly manpower or resource intensive requirement. The NIS system, which provides for headquarters monitoring with minimal expenditure of headquarters resources, may provide a model for developing a system at USACIDC headquarters.

2. Reevaluate the current policy guidance which cited precautions regarding recruitment of sources who are females, commissioned officers, etc.

A. Army Comment: The HQUSACIDC has reevaluated the policy regarding recruitment of sources who are either females or commissioned officers. It was never the intent of either CIDR 195-1 or CIDR 195-15 to foster the impression that such persons should not be recruited as sources. A change to CIDR 195-15 is currently being staffed to effect clarification of the policy intent.

3. Establish formal procedures for documenting sensitive information pertaining to confidential sources rather than current policy allowing agents to record such information in personal notebooks.

A. Army Comment: A formal procedure to document sensitive information pertaining to confidential sources will be incorporated into CIDR 195-15. Use of CID Form 20 will be extended to include confidential sources. Sensitive information on confidential sources will be annotated on this form and will be filed locally. Significant data developed through confidential sources will continue to be recorded and maintained in raw data files.

4. In operating the USACIDC source program, generally provide emergency and extraordinary (.0015) funds only to registered sources.

A. Army Comment: The .0015 funds are provided "generally" only to registered sources. However, the USACIDC considers the one-time payment of these funds to confidential sources an incentive and intends to continue this practice. These payments are rare and are generally issued as a reward or for payment under exigent circumstances. These payments are documented and filed IAW AR 195-4 which does provide a sufficient audit trail for the expenditure of these funds.

B. IG, DoD Response: The thrust of this recommendation is twofold; concern over the audit trail and potential for compromise of the source. Since payments are documented IAW AR 195-4, the audit trail appears to be satisfied. Maintenance of the true name receipt in the case file, however, increases the risk of compromise and should be curtailed immediately. Since these "one-time" payments are rare, USACIDC should develop a mechanism for synoptic source registration in these situations. The source can be registered (minus photograph, declaration of understanding, declaration of cooperation) and terminated in one action. A source file is thereby created to serve as the appropriate repository for the true name receipt and as an accurate memorialization of the sources activity.

5. Explore with the Military Personnel Center the feasibility of extending the period for "masking" the emergency transfer location of a military source.

A. Army Comment: In October 1982, prior to the initiation of this oversight project, this command studied the feasibility of masking moved sources for longer than a 90 day period and determined that it would not be cost effective to change the current policy. During the last five years, this command processed a total of 491 Fear of Life transactions and found no incidents in which a source was subsequently compromised after his initial move via the worldwide location system. However, if USACIDC perceives this to be a problem in the future, we will again explore with the Military Personnel Center the feasibility of extending the masking time.

6. Obtain sufficient wire and oral communications interception equipment for ready access by all field components.

A. Army Comment: Concur. The requirement for additional wire and oral intercept equipment was previously identified by this command. Currently, four kits have been obtained and forwarded to field elements in addition to those supplemented through loan from Army Intelligence units. Seven additional kits are programmed for purchase in FY85. The USACIDC will continue to review the requirement for wire and oral intercept equipment to ensure ready access by field components.

7. Refine the current policy guidance in CIDR 195-15 pertaining to disclosure of the identity of confidential sources.

A. Army Comment The office of the Staff Judge Advocate Office (SJA), HQUSACIDC is drafting changes to para 2-6c and d, CIDR 195-15, to refine policy guidance pertaining to disclosure of the identity of confidential sources. The changes will comport with the guidance at paragraphs B8 and B9 of the IG, DoD memorandum to the Secretary of the Army, dated June 4, 1984.

8. Establish a system for centralized management and control of sensitive initiative operations and registered sources.

A. Army Comment: Because of limited staffing, HQUSACIDC cannot routinely control and manage all sensitive initiative operations. Although some operations are controlled at HQUSACIDC level, utilizing a task force effort, experience has shown that these functions are more successfully executed at the region level. Such operations are not initiated without concurrence of this headquarters. Also, sensitive initiative operations are closely monitored through established reporting systems and by frequent internal communications between commanders and staffs.

B. IG, DoD Response: The USACIDC Headquarters should have the capability to monitor the current status and manage all sensitive initiative operations and registered sources. Headquarters management does not necessarily mean that headquarters is controlling day to day operations and sources. Obviously, sufficient operational latitude must be given to local and regional commanders. The headquarters function must be to support, approve where necessary, and provide timely oversight for sensitive activities in consonance with the Attorney General's guidelines.

Navy

1. In the near term, develop a criminal information management system capable of analyzing trends, locations, modus operandi, and potential targets for future criminal initiative efforts.

A. Navy Comment: Concur. In April 1984, a criminal research analyst was employed by the Naval Investigative Service in the Special Operations Division. The duties of this analyst include development of a computer data system capable of analyzing trends, locations, modus operandi and potential targets for future criminal initiative efforts. Research is ongoing presently to procure computer hardware and software and obtain additional criminal analytical training for the assigned analyst. Additionally, liaison has been effected with the USACIDC to examine their Manual/Automated Criminal Information System (MACIS) to determine the feasibility of implementing a similar system within the NIS.

2. Develop a course of instruction, conduct psychological screening and issue a policy statement regarding use of special agents in an undercover capacity.

A. Navy Comment: Concur. A comprehensive manual change detailing NIS policy regarding use of special agents in an undercover capacity will be promulgated in the near future. A billet has been established for a clinical psychologist at NIS Headquarters, which will be filled during early FY 85. The psychologist will assist in the psychological screening of volunteers for undercover assignments. Instruction regarding special agents operating in an undercover capacity and undercover operations has been expanded within the framework of an Advanced Criminal Investigators' course at NIS Headquarters. Courses on undercover operations presented by the Air Force Office of Special Investigations and the Bureau of Alcohol, Tobacco and Firearms are in the process of being evaluated by the Special Operations Division, with the long-term goal being the establishment of an undercover operations course at NIS Headquarters.

3. Develop a computerized record of data identifying particular abilities, language capabilities, etc., of all undercover agents.

A. Navy Comment: Concur. As part of the aforementioned manual change regarding undercover operations, a questionnaire, similar to that used by the Federal Bureau of Investigation, soliciting volunteers for undercover assignments will be distributed to all NIS special agents. The questionnaire will identify particular abilities, language capabilities, previous experience, hobbies, etc., and will facilitate the establishment of a data bank of special agents who have volunteered for an undercover assignment. This process will expedite the selection of the most capable agent for a particular operation.

4. Curtail the requirement that a source's commanding officer be apprised of and approve source utilization.

A. Navy Comment: Nonconcur. Within the Naval Service, the Commanding Officer has the ultimate responsibility for the safety and welfare of his command members. Notification of a Commanding Officer has not proven a hindrance in conducting operations, and conversely the Commanding Officer can provide valuable assistance if a source's relationship with NIS necessitates a TAD or PCS safety transfer. Additionally, the Commanding Officer provides valuable information regarding the potential source during the screening and vetting stages of recruitment which could prevent major problems in the future. Rare occasions arise when, in the opinion of the special agent in charge, it would not be beneficial to obtain the permission of the Commanding Officer. In these instances approval is obtained from higher naval authority.

B. IG, DoD Response: Curtailing the requirement that a source's Commanding Officer be apprised of and approve source utilization does not infringe on the Commander's authority or responsibility for the safety and welfare of command members. Revealing the identity of a source to the Com…anding Officer and seeking utilization approval is not only a disservice to the source but prevents the investigative organization from conducting totally independent inquiries. The source's knowledge that his Commanding Officer is aware of his association with the investigative organization can stifle source performance and even prevent reporting of information that the source believes is embarassing to the command or the Commanding Officer. The Army and Air Force models have worked successfully for years. Although some Army and Air Force commanders occasionally voice objection to this policy, the Army and Air Force realize that an independent source program is a basic support function required of investigative organizations. Commanders in the Army and Air Force are generally apprised of the mechanics of source programs and the availability of emergency transfers; but source identities are seldom released, and never without the source's approval.

There is no question that a Commanding Officer may be able to provide valuable assistance to the special agent in identifying potential sources, and this tactic can be successfully employed during screening without actually identifying which of the potential sources is later selected. Similarly, Commanding Officers provide valuable assistance during emergency transfer procedures. With a general knowledge of the source program, most Commanding Officers will be ready to assist should such procedures be required.

5. Explore with Navy Military Personnel Command and Headquarters, U.S. Marine Corps, the feasibility of "masking" the new location of a source transferred on an emergency basis.

A. Navy Comment: Nonconcur. The security of the NIS source transfer program is under constant review for integrity. The Navy Military Personnel Command (NMPC) runs a centralized computerized system which prohibits the "masking" of a new location for a source without seriously impairing source's future personnel actions. Discussions with NMPC determined that "masking" a source's location creates dangers to the source at the new duty assignment as the personnel detachments would discern the new member had special status and, therefore, would be compromised. Experience since 1976 has not developed a need for "masking" the source's new location. Infrequently, sources have had to be reassigned a second time when compromised at their new assignment. These second reassignments are conducted readily and quickly.

Additionally, sources may be and have been discharged at their request from the Navy rather than placing them in a dangerous situation.

B. IG, DoD Response: The thrust of this recommendation is to insure the safety of a source transferred on an emergency basis. If the current regulations satisfactorily meet that requirement, there is no objection to continuing with the current program.

6. Develop a documented system for the emergency transfer of civilian sources and a program to assist them in obtaining new employment.

A. Navy Comment: Concur. Research will be conducted with appropriate civilian personnel specialists to determine the feasibility of implementing a program for the emergency transfer of civilian sources and a program to assist them in gaining new employment.

AIR FORCE

1. Establish a system for centralized management and control of sensitive initiative operations and registered sources.

A. Air Force Comment: Only centralized oversight, not control, of initiative operations is necessary. In the past, some measure of control over these operations was derived from the fact that most of the "tools" investigators needed to conduct these operations could only be utilized based upon obtaining approval for their use from HQ AFOSI. With the evolution of AFOSI's offensive philosophy, the need was recognized to delegate the authorities to use these "tools" whenever possible to the lowest level possible. This has occurred, and with the exception of limits placed on contingency funds expenditures and consensual/non-consensual intercepts, the AFOSI district commander concerned can conduct an investigative operation at the time it is needed or required to satisfy the desire of the commanders we service. To require a district to obtain approval for an operation from HQ AFOSI undermines the authority of the district commander, increases the risk of compromise, and increases the time necessary to mount the operation. The environment in which criminal operations are conducted is not static and changes from day to day. By keeping the authority to conduct an operation as close to the criminal enterprise as possible, the decision to go ahead or not is based on the most current information available. In the past, when the majority of operational approvals rested at headquarters, decisions were often made on information which was outdated and they were no longer valid since the situation had changed. The same basic principles that apply to initiative operations are also appropriate for the AFOSI source program. The AFOSI previously had a system which was designed to provide centralized management and control. This system was too cumbersome and tended to delay operational value, created OPSEC problems, and stifled field agents thinking for themselves. The overall management of both initiative operations and the source program is rightfully entrusted to the AFOSI district commanders. They are among the most senior officers in AFOSI, having a wealth of operational experience within the organization. They are thoroughly familiar with the legal and organizational limits placed on AFOSI activities and best know the capabilities of their units and personnel. As such, they are the persons best suited to make these crucial operational decisions.

B. IG, DoD Response: The intent of this recommendation is not to require headquarters approval on all initiative operations or for utiliation of registered sources. Approval for registered sources is appropriately accomplished in the field. The approval of initiative operations can usually be accomplished at the field level. In accordance with the Attorney General's guidelines, however, it is the intention of this recommendation to require headquarters approval for those certain categories of operations enumerated in the guidelines.

The term "centralized control" as used in the recommendation did not mean the total day to day management of initiative operations or registered sources by headquarters elements. Rather, centralized management and control refers to a comprehensive and timely oversight program. This program should include maintenance of current files reflecting the status, productivity and problems associated with each initiative operation and registered source. Current files on operations and sources insure the capability for a swift headquarters reaction in critical situations. Likewise, constant review and analysis of headquarters files provides the capability to disseminate innovative ideas among districts and insures uniform compliance with established operational procedures. Most importantly, centralized management of sources and operations provides direct support to the AFOSI field commander. Perceived OPSEC problems are easily overcome by adherence to proper security controls. A review of the NIS model for centralized operational and source management, a system that has worked successfully for years, is worthy of consideration.

2. Establish a system for periodic reporting of the productivity and expenses of all registered sources to AFOSI Headquarters.

A. Air Force Comment: The productivity of a registered source is fully documented in the source's dossier maintained by the AFOSI detachment using that source. Periodic reporting of this information to headquarters level would create duplicate files with no increase in benefit. Should it ever become necessary for HQAFOSI to know the productivity for a particular source, the information can be requested and obtained within a reasonable time. Information on expenses can also be obtained from the detachment.

B. IG, DoD Response: The thrust of this recommendation echos the intent of the previous recommendation, i.e., establishing a centralized management system for initiative operations and registered sources.

3. Expend E&E funds only on registered sources.

A. Air Force Comment: The recommendation indicates that emergency and extraordinary funds be provided only to registered (carded) sources. We concur with this recommendation if, and only if, a registered (carded) source is defined as one who has been documented in a source file or who is having a source file developed. This would include a potential source who needs to be enticed to work for AFOSI. To date, the AFOSI source program has operated productively without this recommended restriction; its implementation now would only add confusion to the program.

B. IG, DoD Response: The definition of a registered source is one who has been documented and who is being tasked to collect information. Enticement or inducement of a potential source can fit into the broad meaning of tasking and payment can be made as long as there is documentation covering his or her development and, if successful, registration.

4. Establish a policy for filing true name receipts of registered sources and any other documents which identify the source in the source dossier to preclude compromise.

A. Air Force Comment: Implementation of this recommendation would require additional AFOSI administrative personnel to support it. Quality control at district level insures that all documents filed in the case file are properly identified to preclude compromise. The current AFOSI system has been adequate and has the added advantage of having everything related to a specific case available in one file.

B. IG, DoD Response: The proper repository for true name source receipts as well as other documents which identify a source is the source dossier. Filing such documents in a case file provides more chance of compromise than filing in a source dossier.

5. Improve the headquarters capability for analysis and assessment of the extensive fraud intelligence currently being collected and reported by field units.

A. Air Force Comment: AFOSI has long recognized the need for improved analysis of their fraud program and that was one of the basic reasons for a current reorganization with HQ AFOSI. Under this reorganization there will be a separate Analysis Division within the combined Criminal/Fraud Investigations Directorate to look at specific, fraud related topics. There will also be a separate Analysis Directorate which will look at overall management trends, including the command-wide status of the fraud program.

DCIS

1. Promulgate formal policy regarding the recruitment, administrative control and management of confidential informants.

A. DCIS Comment: Concur. DCIS is currently drafting formal guidelines on confidential informants.

2. Promulgate formal policy regarding the development and control of initiative and undercover operations.

A. DCIS Comment: Concur. DCIS is currently drafting formal guidelines on undercover operations.

3. Develop a course of instruction, conduct psychological screening and issue a policy statement regarding utilization of special agents in an undercover capacity.

A. DCIS Comment: Concur in the need to develop a course of instruction and formal policy on undercover operations. The latter, as stated above, is currently being drafted. Nonconcur in the need for psychological screening. All DCIS agents are carefully screened at time of selection and continuously observed by supervisors under stressful conditions. The day-to-day physical observation of an agent working under stress by a supervisor is a far better barometer of an agent's ability to function in an undercover environment than any battery of tests.

B. IG, DoD Response: Screening an individual for employment as a DCIS special agent is significantly different than evaluating someone to operate in a covert capacity. Selection criteria for undercover agents must include psychological interviews and testing, and specialized training. Further, since many undercover operations result in significant stress on the undercover agent, these operations must be closely monitored by headquarters. The undercover agent must operate under the personal direction of a seasoned special agent handler.

4. Attempt to increase the amount of authorized E&E funds and distribute an appropriate amount to each field component.

A. DCIS Comment: Concur. DCIS recently received an additional $15,000 in Emergency and Extraordinary Expense Funds for the remainder of FY 84.

5. Obtain sufficient wire and oral communications interception equipment for ready access by all field components.

A. DCIS Comment: Concur.

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

TAB 4

17 AUG 1984

MEMORANDUM FOR SECRETARY OF DEFENSE

SUBJECT: Allegations of gratuities received by
Admiral Hyman Rickover--ACTION MEMORANDUM

Attached is the correspondence received by my office from the Department of Justice (DOJ) concerning allegations that General Dynamics provided gratuities to Admiral Hyman Rickover.

While criminal prosecution seems unlikely due to statute of limitations problems, further fact gathering will be necessary to determine what civil and administrative remedies might be applicable.

Since the Navy has already begun a review into these allegations, I recommend that you sign the attached memorandum to the Secretary of the Navy directing a prompt and complete determination of all relevant facts. The proposed memorandum also provides that my office will monitor the Navy investigation so that an assessment, on your behalf, of its adequacy may be made. I will also provide the General Counsel with any information received from the Navy to ensure proper legal oversight.

Joe Sherick
Joseph H. Sherick
Inspector General

Enclosure

BEST CO[illegible]BLE

THE SECRETARY OF DEFENSI
WASHINGTON, THE DISTRICT OF COLU

MEMORANDUM FOR SECRETARY OF THE NAVY

SUBJECT: Allegations of gratuities received by Admiral Hyman Rickover

Based on the attached incoming correspondence from the Department of Justice to the Inspector General, Department of Defense, the Department of the Navy should conduct a prompt and complete determination of the allegations contained therein. I view the information conveyed by the Department of Justice to be extremely serious and of a nature that requires your personal attention to ensure a satisfactory resolution.

In conjunction with the Department of Justice, the Department of the Navy should ensure that all appropriate criminal, civil and administrative remedies are pursued in this matter. Investigative efforts should be undertaken by the Navy to assess the scope of these allegations, including a determination of whether other naval officers were recipients of gratuities.

I will ask the Inspector General to keep me apprised of the status of this matter. Arrangements should be made for regular status reports to him.

Cap Weinberger

Enclosure

THE SECRETARY OF THE NAVY
WASHINGTON, D. C. 20350

1 September 1984

Cap

MEMORANDUM FOR THE ~~SECRETARY~~ OF DEFENSE

Subj: Allegations of Gratuities Received by Admiral Hyman Rickover -- INFORMATION MEMORANDUM

In answer to your 22 August memorandum, the Navy, on 1 August 1984, initiated an investigation into allegations of gifts to Admiral Rickover and to determine whether gifts were made to other Navy officials. All criminal, civil, and administrative remedies will be pursued and the DOD Inspector General will be kept apprised.

John

John Lehman

I'll keep you posted

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

TAB 5

MAY 20 1985

Honorable Robert C. Bonner
United States Attorney
Central Judicial District
of California
312 North Spring Street
Los Angeles, CA 90012

Dear Mr. Bonner:

As the Inspector General, Department of Defense (DoD), Congress gave me the job of promoting efficiency and economy, and detecting and preventing fraud, waste and abuse. This is a very big job and one in which I find need for a great deal of assistance. The vigorous and prompt prosecution of those who perpetrate fraud against the DoD is, of course, a major factor in deterring this type of activity. I am soliciting your assistance in emphasizing this deterrent to the defense industry within the Central District of California.

The impact of DoD expenditures in your judicial district is significant. During January 1985, the Defense Contract Administration Services Region in Los Angeles administered contracts for procurements valued at approximately $17 billion. These procurements involved 5,450 prime contractors and 76,062 contracts for virtually every item in the DoD inventory from bolts and screws to aircraft, missiles, tanks, and ships.

Only three Defense Criminal Investigative Service (DCIS) cases have resulted in successful criminal prosecutions in the Central District of California. These prosecutions consisted of two medical benefits (Office of Civilian Health and Medical Programs of the Uniformed Services) cases which identified losses of approximately $43,000, and a significant contract fraud case which was prosecuted by an attorney from the Defense Procurement Fraud Unit, Department of Justice. The DCIS has 10 other cases currently awaiting prosecutive determinations by your office.

The disposition of the following criminal investigations are of particular interest to me. I ask your assistance in giving them priority attention:

DELETION - Pending Case Information

DELETION - Pending Case Information

o SYSTEMS ENGINEERING & TECHNOLOGY ASSOCIATES (SETAC), N83600026T - Mr. Thomas Snooks, President of SETAC, is alleged to have regularly and knowingly mischarged time costs to Government contracts through manipulation and alteration of time records. Four witnesses are willing to testify that Mr. Snooks made blatant alteration of employee time reports in his effort to mischarge the Government. Estimated loss to the Government is over $100,000.

o DISTRICT INTERNATIONAL SUPPLY COMPANY, N8460021W - On February 27, 1984, the DCIS began an investigation of an allegation from an industrial specialist, Defense Contract Administration Services Management Area - Santa Ana, that this contractor was falsifying product certifications for metal and steel products. As a result of interviews, the allegations were substantiated. A review of product certifications obtained from the company has disclosed signs of alteration on several certificates. Some of the metals were to be used in critical applications within DoD. Estimated loss to the Government is $400,000.

DELETION - Pending Case Information

I understand that you recently implemented a procedure which allows DCIS cases to be referred directly to your major fraud unit to expedite the preliminary review process. I also understand that you are considering the dedication of three special assistants to handle DoD white collar crime cases. I certainly applaud the former and strongly support the latter. I feel that both of these actions will enhance our mutual objectives, and I assure you that my office is willing to provide dedicated investigators in support of this effort.

Mr. Bert Truxell, Assistant Inspector General for Investigations, and Mr. Michael Eberhardt, Assistant Inspector General for Criminal Investigations Policy and Oversight, expect to be in the Los Angeles area during the latter part of June. I have asked them to make a particular effort to meet with you to discuss the cases I have cited, as well as other matters of mutual interest.

Sincerely,

Sherick
Joseph H. Sheric
Inspector General

THE SECRETARY OF DEFENSE
WASHINGTON THE DISTRICT OF COLUMBIA

TAB 7

30 MAR 1985

Honorable Edwin Meese, III
Attorney General
Washington, D.C. 20530

Dear Ed:

As you may be aware, the last few years have seen a marked improvement in the cooperative relationship between the Departments of Defense and Justice in our commitment to improve the capability to investigate and prosecute procurement fraud cases. As I review our progress, I am convinced that there are certain fraud cases that have a particularly devastating effect on our readiness capability; these are cases involving allegations of product substitution. Shoddy and substandard products must not be tolerated if our national defense objectives are to be obtained.

Accordingly, I am making a personal commitment to ensure that all Defense personnel understand their obligation to identify and report any situation indicative of product substitution by Defense contractors. Intentional conduct causing product substitution will result in our use of all remedies available to the Department of Defense, including debarment.

While I realize that the Justice Department generally recognizes the importance of product substitution cases, I would urge that you reiterate to all United States Attorneys that product substitution cases should be regarded as top priorities in commencing criminal and civil fraud actions.

I am convinced that our concerted effort in this area can have a meaningful impact in ensuring that our readiness capability is not seriously undermined by future incidents of product substitution.

Sincerely,

Cap

THE ATTORNEY GENERAL
WASHINGTON

24 April 1985

Dear Cap:

Thanks for your letter of March 30, 1985, emphasizing the significance of product substitution cases. We share your concern in this area and will be giving product substitution actions the priority attention they require.

Enclosed is a copy of a memorandum I have sent to the United States Attorneys reemphasizing the importance of this category of procurement cases. I look forward to close cooperation between our departments on this score.

With kindest personal regards,

Sincerely,

Edwin Meese III

Honorable Caspar W. Weinberger
Secretary of Defense
The Pentagon
Washington, D. C. 20301

cc: Honorable William H. Webster

Office of the Attorney General
Washington, D.C. 20530

29 April 1985

MEMORANDUM TO: ALL UNITED STATES ATTORNEYS

FROM: EDWIN MEESE III
Attorney General

SUBJECT: Product Substitution in Department of Defense Procurements

The Secretary of Defense has asked that I reemphasize to all United States Attorneys the Department's policy that procurement fraud cases involving product substitution should be regarded as a top priority. A copy of the Secretary's letter is attached.

You are all aware of the Administration's efforts to eliminate waste, fraud, and abuse in government programs generally. Secretary Weinberger has determined that fraud involving shoddy and substandard products is a particular problem in defense procurement. Accordingly, I want you to treat cases of this sort as a priority of the Department of Justice. Please pursue appropriate criminal and civil actions vigorously.

This gives us an opportunity to work closely with the Defense Department on a matter of considerable importance to the President's program. Please convey this commitment to all of your Assistants.

Thank you for your assistance.

Attachment

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON D.C. 20301

TAB B

3 MAY 1985

Honorable Stephen S. Trott
Assistant Attorney General
Criminal Division
Department of Justice
Washington, DC 20530

Dear Mr. Trott:

In light of the recent attention given to delays in reaching a prosecutive decision on the investigation of Pratt and Whitney, I would recommend that an examination be conducted of the current inventory of cases in the United States Attorneys Offices to identify other potentially significant investigations which may have been unnecessarily delayed. While many of these investigations involve complex issues of law and fact, I am sure you share my concern that individual United States Attorneys appreciate the need for timely disposition of these cases.

Therefore, besides urging you to ensure that an immediate decision is rendered regarding the prosecution of Pratt and Whitney, I have asked Mr. Michael C. Eberhardt, my Assistant Inspector General for Criminal Investigations Policy and Oversight, to work with the Defense Procurement Fraud Unit to identify the status of all investigations involving the top 100 Department of Defense contractors.

I would hope that our concerted efforts to avoid delays in significant cases will ensure that all United States Attorneys develop an understanding of why Department of Defense procurement fraud cases must be viewed with the greatest priority.

Sincerely,

SIGNED

Joseph H. Sherick
Inspector General

OFFICE OF THE SECRETARY OF DEFENSE
WASHINGTON D.C. 20301
view and Oversight)

TAB 9

2 DEC 1981

Mr. D. Lowell Jensen
Assistant Attorney General
Criminal Division
Department of Justice
Washington, D.C. 20530

Dear Mr. Jensen:

I believe it is essential that we take timely action to prosecute criminal fraud against the Federal Government. Prompt prosecution is likely to help deter crime. In order to eliminate the backlog of older fraud cases still pending, the Defense Department reviewed those that had been referred to your department. We identified 21 cases where your division or the responsible U.S. Attorney indicated there was prosecutive merit, but prosecution has been delayed for a substantial period. We have been unable to determine the reasons for these delays.

I have enclosed summaries of the 21 cases for your review. A summary of a similar case involving the Lockheed Aircraft Company is also enclosed. Although this case was determined to lack prosecutive merit, I think it warrants reconsideration.

I would like to meet with you within the next two weeks to discuss the appropriate course of action necessary to conclude these cases. I appreciate your assistance in clearing up the backlog.

Sincerely,

SIGNED

Joseph H. Sherick
Assistant to the Secretary of Defense
(Review and Oversight)

Enclosures

U.S. Department of Justice

Criminal Division

Deputy Assistant Attorney General

Washington, D.C. 20530

JAN -5 1982

Mr. Joseph H. Sherick
Assistant to the Secretary of Defense
(Review and Oversight)
Room 3E1081, Pentagon
Washington, DC 20301

Dear Mr. Sherick:

I enjoyed the opportunity to meet with you on December 16 and to discuss with you our mutual concerns regarding the most efficient manner of addressing fraud and abuse in the various program and procurement areas of the Department of Defense (DOD). As we discussed, one of the first steps in accomplishing this goal is to establish frequent and open communication between our Departments. The frequency of such meetings will encourage our respective staffs to have more open lines of communication. An informal committee with representatives from the Fraud Section, your office and the military services (OSI, CID, NIS) which would periodically meet to consider mutual DOD/DOJ enforcement concerns would be a vehicle for opening up the lines of communications at the operations level. I would like to reemphasize our interest in establishing such a working committee.

I very much appreciated your support of the Department's Fraud and Corruption Tracking (FACT) System. We anticipate that the FACT System will help insure that the federal government's attack on fraud, waste, abuse and corruption is efficiently and effectively managed. The System's successful implementation will require, as you acknowledged, the cooperation and participation of all departments.

Finally, since our December 16 meeting was occasioned by your letter to Lowell Jensen, dated December 2, 1981, inquiring about the status of twenty-two pending cases, I have enclosed a copy of a report prepared by Harold Damelin, Chief of our Government Fraud Branch in the Fraud Section, which sets forth the current status of each of the cases. If you have questions, please feel free to call me (633-2636) or Mr. Damelin (724-7121).

I am looking forward to working with you.

Sincerely,

Roger M Olsen

Roger M. Olsen

Honorable Stephen S. Trott
Assistant Attorney General
Criminal Division
Department of Justice
Washington, DC 20530

23 NOV 1983

Dear Mr. Trott:

Over the past two and one-half years, the Air Force Office of Special Investigations (AFOSI) has been involved in two investigations involving significant allegations of cost mischarging by General Electric. These investigations relate to the Space Systems Division and Reentry Systems Division of General Electric and are related generally to another cost mischarging investigation involving General Electric, which is being investigated by the Office of the Inspector General at the National Aeronautics Space Administration (NASA) along with the Federal Bureau of Investigation (FBI). While all three matters are pending for prosecutive decision in the United States Attorney's Office in Philadelphia, the NASA/FBI investigation is apparently being given priority; a decision as to the prosecutive merits on that investigation will apparently be made before consideration of the merits of the AFOSI matters.

It is my understanding that all three of these cases are somewhat complex and are assigned to the same Assistant United States Attorney, who has other caseload responsibilities. Under these circumstances, and in view of the fact that expertise has been developed by the Department of Justice Procurement Fraud Unit in cost mischarging cases, I request that the Unit examine these cases in order to expedite the decision concerning the prosecutive merits of the AFOSI cases. Each of these cases involves substantial Air Force contracts and a prompt decision is in the best interest of the Department of Defence.

Your cooperation in this matter will be appreciated.

Sincerely,

SIGNED

Joseph H. Sherick
Inspector General

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

TAB 11

24 AUG 1983

Mr. Frank W. Donaldson
United States Attorney for
Northern Alabama
200 Federal Building
1800 Fifth Avenue North
Birmingham, Alabama 35203

Dear Mr. Donaldson:

With enactment of legislation in 1982 creating an Inspector General for the Department of Defense, Congress and the Administration made a strong commitment to detect and prevent fraud affecting the Department. As the first Inspector General for the Department of Defense, I would like to solicit your support and assistance in pursuing criminal or civil actions relating to fraud or corruption in defense programs and activities.

With an organizational strength of approximately 1,000 auditors, investigators, and inspectors, fully supported by the more than 18,000 auditors, investigators and inspectors of the Military Departments as needed, I expect to meet my statutory responsibilities. In order to be fully successful, however, I also need a constructive partnership with you and the Department of Justice in pursuing the conviction of individuals or corporations who seek to undermine our defense effort through illegal actions. To this end, I have directed my investigators to work closely with you, other Federal prosecutors, and other Federal law enforcement agencies to ensure full and timely coordination of our efforts.

I have enclosed an organizational chart of my office and a listing of the field offices associated with my investigative arm, the Defense Criminal Investigative Service. The Defense Criminal Investigative Service is headed by Mr. Brian M. Bruh, my Assistant Inspector General for Investigations. Your district is within the coverage of our investigative office located at Atlanta, Georgia, where the Special Agent in Charge is Mr. Ellis C. Baker, telephone (404)429-6170. Please feel free to call him on any matter involving the Department of Defense.

Please let me know if you have any ideas or suggestions that will improve the way I carry out my responsibilities. Also, do not hesitate to call to my attention any problems you might encounter in support of this effort. Thank you for your past support.

Sincerely,

Joe Sherick
Joseph H. Sherick
Inspector General

Enclosures

MEMORANDUM OF UNDERSTANDING BETWEEN THE DEPARTMENTS OF JUSTICE AND DEFENSE RELATING TO THE INVESTIGATION AND PROSECUTION OF CERTAIN CRIMES

A. PURPOSE, SCOPE AND AUTHORITY

This Memorandum of Understanding (MOU) establishes policy for the Department of Justice and the Department of Defense with regard to the investigation and prosecution of criminal matters over which the two Departments have jurisdiction. This memorandum is not intended to confer any rights, benefits, privileges or form of due process procedure upon individuals, associations, corporations or other persons or entities.

This Memorandum applies to all components and personnel of the Department of Justice and the Department of Defense. The statutory bases for the Department of Defense and the Department of Justice investigation and prosecution responsibilities include, but are not limited to:

1. Department of Justice: Titles 18, 21 and 28 of the United States Code; and

2. Department of Defense: The Uniform Code of Military Justice, Title 10, United States Code, Sections 801-940; the Inspector General Act of 1978, Title 5 United States Code, Appendix I; and Title 5 United States Code, Section 301.

B. POLICY

The Department of Justice has primary responsibility for enforcement of federal laws in the United States District Courts. The Department of Defense has responsibility for the integrity of its programs, operations and installations and for the discipline of the Armed Forces. Prompt administrative actions and completion of investigations within the two (2) year statute of limitations under the Uniform Code of Military Justice require the Department of Defense to assume an important role in federal criminal investigations. To encourage joint and coordinated investigative efforts, in appropriate cases where the Department of Justice assumes investigative responsibility for a matter relating to the Department of Defense, it should share information and conduct the inquiry jointly with the interested Department of Defense investigative agency.

It is neither feasible nor desirable to establish inflexible rules regarding the responsibilities of the Department of Defense and the Department of Justice as to each matter over which they may have concurrent interest. Informal arrangements and agreements within the spirit of this MOU are permissible with respect to specific crimes or investigations.

C. INVESTIGATIVE AND PROSECUTIVE JURISDICTION

1. CRIMES ARISING FROM THE DEPARTMENT OF DEFENSE OPERATIONS

a. Corruption Involving the Department of Defense Personnel

The Department of Defense investigative agencies will refer to the FBI on receipt all significant allegations of bribery and conflict of interest involving military or civilian personnel of the Department of Defense. In all corruption matters the subject of a referral to the FBI, the Department of

Defense shall obtain the concurrence of the Department of Justice prosecutor or the FBI before initiating any independent investigation preliminary to any action under the Uniform Code of Military Justice. If the Department of Defense is not satisfied with the initial determination, the matter will be reviewed by the Criminal Division of the Department of Justice.

The FBI will notify the referring agency promptly regarding whether they accept the referred matters for investigation. The FBI will attempt to make such decision in one (1) working day of receipt in such matters.

b. Frauds Against the Department of Defense and Theft and Embezzlement of Government Property

The Department of Justice and the Department of Defense have investigative responsibility for frauds against the Department of Defense and theft and embezzlement of Government property from the Department of Defense. The Department of Defense will investigate frauds against the Department of Defense and theft of government property from the Department of Defense. Whenever a Department of Defense investigative agency identifies a matter which, if developed bv investigation, would warrant federal prosecution, it will confer with the United States Attorney or the Criminal Division, the Department of Justice, and the FBI field office. At the time of this initial conference, criminal investigative responsibility will be determined by the Department of Justice in consultation with the Department of Defense.

2. CRIMES COMMITTED ON MILITARY INSTALLATIONS

a. Subject(s) can be Tried by Court-Martial or are Unknown

Crimes (other than those covered by paragraph C.1.) committed on a military installation will be investigated by the Department of Defense investigative agency concerned and, when committed by a person subject to the Uniform Code of Military Justice, prosecuted by the Military Department concerned. The Department of Defense will provide immediate notice to the Department of Justice of significant cases in which an individual subject/victim is other than a military member or dependent thereof.

b. One or More Subjects cannot be Tried by Court-Martial

When a crime (other than those covered by paragraph C.1.) has occured on a military installation and there is reasonable basis to believe that it has been committed by a person or persons, some or all of whom are not subject to the Uniform Code of Military Justice, the Department of Defense investigative agency will provide immediate notice of the matter to the appropriate Department of Justice investigative agency unless the Department of Justice has relieved the Department of Defense of the reporting requirement for that type or class of crime.

3. CRIMES COMMITTED OUTSIDE MILITARY INSTALLATIONS BY PERSONS WHO CAN BE TRIED BY COURT-MARTIAL

a. Offense is Normally Tried by Court-Martial

Crimes (other than those covered by paragraph C.1.) committed outside a military installation by persons subject to the Uniform Code of Military Justice which, normally, are tried by court-martial will be investigated and prosecuted by the Department of Defense. The Department of Defense will provide immediate notice of significant cases to the appropriate Department of Justice investigative agency. The Department of Defense will provide immediate notice in all cases where one or more subjects is not under military jurisdiction unless the Department of Justice has relieved the Department of Defense of the reporting requirement for that type or class of crime.

b. Crimes Related to Scheduled Military Activities

Crimes related to scheduled military activities outside of a military installation, such as organized maneuvers in which persons subject to the Uniform Code of Military Justice are suspects, shall be treated as if committed on a military installation for purposes of this Memorandum. The FBI or other Department of Justice investigative agency may assume jurisdiction with the concurrence of the United States Attorney or the Criminal Division, Department of Justice.

c. Offense is not Normally Tried by Court-Martial

When there are reasonable grounds to believe that a Federal crime (other than those covered by paragraph C.1.) normally not tried by court-martial, has been committed outside a military installation by a person subject to the Uniform Code of Military Justice, the Department of Defense investigative agency will immediately refer the case to the appropriate Department of Justice investigative agency unless the Department of Justice has relieved the Department of Defense of the reporting requirement for that type or class of crime.

D. REFERRALS AND INVESTIGATIVE ASSISTANCE

1. REFERRALS

Referrals, notices, reports, requests and the general transfer of information under this Memorandum normally should be between the FBI or other Department of Justice investigative agency and the appropriate Department of Defense investigative agency at the field level.

If a Department of Justice investigative agency does not accept a referred matter and the referring Department of Defense investigative agency then, or subsequently, believes that evidence exists supporting prosecution before civilian courts, the Department of Defense agency may present the case to the United States Attorney or the Criminal Division, Department of Justice, for review.

2. INVESTIGATIVE ASSISTANCE

In cases where a Department of Defense or Department of Justice investigative agency has primary responsibility and it requires limited assistance to pursue outstanding leads, the investigative agency requiring assistance will promptly advise the appropriate investigative agency in the other Department and, to the extent authorized by law and regulations, the requested assistance should be provided without assuming responsibility for the investigation.

E. PROSECUTION OF CASES

1. With the concurrence of the Department of Defense, the Department of Justice will designate such Department of Defense attorneys as it deems desirable to be Special Assistant United States Attorneys for use where the effective prosecution of cases may be facilitated by the Department of Defense attorneys.

2. The Department of Justice will institute civil actions expeditiously in United States District Courts whenever appropriate to recover monies lost as a result of crimes against the Department of Defense; the Department of Defense will provide appropriate assistance to facilitate such actions.

3. The Department of Justice prosecutors will solicit the views of the Department of Defense prior to initiating action against an individual subject to the Uniform Code of Military Justice.

4. The Department of Justice will solicit the views of the Department of Defense with regard to its Department of Defense-related cases and investigations in order to effectively coordinate the use of civil, criminal and administrative remedies.

F. MISCELLANEOUS MATTERS

1. THE DEPARTMENT OF DEFENSE ADMINISTRATIVE ACTIONS

Nothing in this Memorandum limits the Department of Defense investigations conducted in support of administrative actions to be taken by the Department of Defense. However, the Department of Defense investigative agencies will coordinate all such investigations with the appropriate Department of Justice prosecutive agency and obtain the concurrence of the Department

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of Justice prosecutor or the Department of Justice investigative agency prior to conducting any administrative investigation during the pendency of the criminal investigation or prosecution.

2. SPECIAL UNIFORM CODE OF MILITARY JUSTICE FACTORS

In situations where an individual subject to the Uniform Code of Military Justice is a suspect in any crime for which a Department of Justice investigative agency has assumed jurisdiction, if a Department of Defense investigative agency believes that the crime involves special factors relating to the administration and discipline of the Armed Forces that would justify its investigation, the Department of Defense investigative agency will advise the appropriate Department of Justice investigative agency or the Department of Justice prosecuting authorities of these factors. Investigation of such a crime may be undertaken by the appropriate Department of Defense investigative agency with the concurrence of the Department of Justice.

3. ORGANIZED CRIME

The Department of Defense investigative agencies will provide to the FBI all information collected during the normal course of agency operations pertaining to the element generally known as "organized crime" including both traditional (La Cosa Nostra) and nontraditional organizations whether or not the matter is considered prosecutable. The FBI should be notified of any investigation involving any element of organized crime and may assume jurisdiction of the same.

4. DEPARTMENT OF JUSTICE NOTIFICATIONS TO DEPARTMENT OF DEFENSE INVESTIGATIVE AGENCIES

a. The Department of Justice investigative agencies will promptly notify the appropriate Department of Defense investigative agency of the initiation of the Department of Defense related investigations which are predicated on other than a Department of Defense referral except in those rare instances where notification might endanger agents or adversely affect the investigation. The Department of Justice investigative agencies will also notify the Department of Defense of all allegations of the Department of Defense related crimes where investigation is not initiated by the Department of Justice.

b. Upon request, the Department of Justice investigative agencies will provide timely status reports on all investigations relating to the Department of Defense unless the circumstances indicate such reporting would be inappropriate.

c. The Department of Justice investigative agencies will promptly furnish investigative results at the conclusion of an investigation and advise as to the nature of judicial action, if any, taken or contemplated.

d. If judicial or administrative action is being considered by the Department of Defense, the Department of Justice will, upon written request, provide existing detailed investigative data and documents (less any federal grand jury material, disclosure of which would be prohibited by Rule 6(e), Federal Rules of Criminal Procedure), as well as agent testimony for use in judicial or administrative proceedings, consistent with Department of Justice and other federal regulations. The ultimate use of the information shall be subject to the concurrence of the federal prosecutor during the pendency of any related investigation or prosecution.

5. TECHNICAL ASSISTANCE

a. The Department of Justice will provide to the Department of Defense all technical services normally available to federal investigative agencies.

b. The Department of Defense will provide assistance to the Department of Justice in matters not relating to the Department of Defense as permitted by law and implementing regulations.

6. JOINT INVESTIGATIONS

a. To the extent authorized by law, the Department of Justice investigative agencies and the Department of Defense investigative agencies may agree to enter into joint investigative endeavors, including undercover operations, in appropriate circumstances. However, all such investigations will be subject to Department of Justice guidelines.

b. The Department of Defense, in the conduct of any investigation that might lead to prosecution in Federal District Court, will conduct the investigation consistent with any Department of Justice guidelines. The Department of Justice shall provide copies of all relevant guidelines and their revisions.

7. APPREHENSION OF SUSPECTS

To the extent authorized by law, the Department of Justice and the Department of Defense will each promptly deliver or make available to the other suspects, accused individuals and witnesses where authority to investigate the crimes involved is lodged in the other Department. This MOU neither expands nor limits the authority of either Department to perform apprehensions, searches, seizures, or custodial interrogations.

G. EXCEPTION

This Memorandum shall not affect the investigative authority now fixed by the 1979 "Agreement Governing the Conduct of the Defense Department Counterintelligence Activities in Conjunction with the Federal Bureau of Investigation" and the 1983 Memorandum of Understanding between the Department of Defense, the Department of Justice and the FBI concerning "Use of Federal Military Force in Domestic Terrorist Incidents."

Attorney General
United States Department
of Justice

Date: Aug 14, 1984

Secretary of Defense
United States Department
of Defense

Date: August 22, 1984

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

6 DEC 1985

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Subcommittee on Oversight
and Investigations

Honorable John D. Dingell
Chairman
Subcommittee on Oversight and
Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciate the continuing interest of your Subcommittee in the role of the Inspector General and other Department of Defense investigative agencies in connection with major Defense contractors.

On November 18, 1985, I provided you with responses to 24 questions attached to your letter of October 1, 1985. I am enclosing responses to two of the three questions posed in the body of your letter. I hope this material is helpful and responsive to the Subcommittee's needs. The response to the question regarding significant incident reports is not yet completed, and I will send it to you as soon as possible.

Please note that the responses to the third question contains information on open criminal investigations. Accordingly, this information should not be publicly released and is provided for the use of the Subcommittee only.

I am sending a copy of this letter and its enclosures to Representative Broyhill, Ranking Minority Member of the Subcommittee.

Sincerely,

Joe Sherick

Joseph H. Sherick
Inspector General

Enclosures

INSPECTOR GENERAL
RECOMMENDATIONS ON
PROCUREMENT

MAJOR

1. ESTABLISH A SINGLE CONTRACT ADMINISTRATION ORGANIZATION FOR ALL DEPARTMENT OF DEFENSE PROCUREMENTS
2. ELIMINATE DUPLICATION OF AUDIT AND OVERSIGHT EFFORTS (DCAA, DCAS, & SERVICES). "PRESENTING A SINGLE AUDIT FACE TO INDUSTRY"
3. IMPROVE PROGRAM MANAGEMENT FOR SYSTEMS
4. INCREASE EMPHASIS ON CONTRACTOR COST ESTIMATING SYSTEMS AND INCURRED COST AUDITS
5. INCREASE AUDIT EMPHASIS ON SUBCONTRACTOR PROPOSALS; ENSURE THE PRIME CONTRACTOR OR DCAA REVIEWS SUBCONTRACTOR PROPOSALS
6. STRENGTHEN TRUTH-IN-NEGOTIATIONS ACT
7. LIMIT PROFITS ON UNPRICED ORDERS

MINOR

8. REQUIRE TECHNICAL REPRESENTATIVES TO REVIEW PROPOSALS AND ATTEND CONTRACT NEGOTIATIONS
9. ABOLISH UNREASONABLE TIME CONTRAINTS FOR CONTRACT AUDITS
10. IMPROVE ACCOUNTABILITY FOR GOVERNMENT FURNISHED PROPERTY
11. STRENGTHEN DCAA ACCESS TO CONTRACTOR RECORDS (FOR AUDITING PROPOSALS)
12. ACCELERATE ACTION ON PRIOR CONTRACT AUDITS

TWENTY-FIVE OIG RECOMMENDATIONS HAVE RECEIVED DCIMI APPROVAL OR HAVE BEEN INCORPORATED IN THE CONFERENCE REPORT

1 APPROVAL OF OVERHEAD COSTS BY AUDIT DETERMINATION

2 REESTABLISH COST ACCOUNTING STANDARDS BOARD

3 SUBPOENA AUTHORITY FOR DCAA

4 AUDITOR ATTENDANCE AT NEGOTIATIONS DEALING WITH INCURRED OVERHEAD COSTS AND + $10 MILLION PROPOSALS

5 DOD SHOULD CONTINUE TO PROMOTE ESTABLISHMENT OF A PROCEDURE TO PENALIZE FALSE CLAIMS AND STATEMENTS

6 INCREASE DOD FRAUD PROSECUTION BY DOJ--MORE ATTORNEYS

7 ESTABLISH CONTRACTOR FRAUD PREVENTION PROGRAMS--CODE OF CONDUCT

8 TWO YEAR POST EMPLOYMENT RESTRICTION (COOLING-OFF PERIOD) ON FEDERAL/MILITARY CONTRACT OFFICIALS

9 QUALIFICATIONS OF NEW CONTRACTOR SOURCES--INCREASE COMPETITION

10 BREAKOUT OF ITEMS PROCURED FROM PRIME CONTRACTORS TO SOURCE MANUFACTURERS (SPARE PARTS)

11 INCREASING COMPETITION THROUGH IMPROVED TECHNICAL DATA AND MARKET RESEARCH

12 "SHOULD COST" IN NEGOTIATION

13 MANDATORY NEGOTIATIONS BY ELEMENTS OF COST

14 IMPROVE PCO'S ROLE IN ACQUISITION PROCESS--MORE INDEPENDENCE

15 ENHANCE CAPABILITIES OF CORPORATE ADMINISTRATIVE CONTRACTING OFFICERS (CACO)

16 INCREASED CONTRACT ADMINISTRATION EFFECTIVENESS IN CONTROLLING COSTS

17 TIGHTEN FAR/DAR COST PRINCIPLES

18 REEMPHASIZE VALUE ENGINEERING

19 PENALIZE CONTRACTORS FOR UNALLOWABLE OR DEFECTIVE CLAIMS

20 OBTAIN INDUSTRY STANDARD LABOR HOURS FOR COST COMPARISON & CONTRACT NEGOTIATIONS

21 UNIFORM PROCEDURES FOR INDIRECT COSTS

22 IMPROVE DAR COUNCIL OPERATIONS

23 STUDY THE ESTABLISHMENT OF A DEFENSE ACQUISITION AGENCY

24 IMPROVE QUALITY AND INDEPENDENCE OF PROCUREMENT PERSONNEL--TRAINING--ORGANIZATIONAL PLACEMENT

25 INCREASED FIELD AUDITS OF NEGOTIATED CONTRACTS

INVESTIGATIONS INVOLVING TOP 100 DEFENSE CONTRACTORS AS OF MAY 1, 1985

CONTRACTOR	DATE OPENED	OCT 1, 1985 STATUS	FRAUD OR OTHER ALLEGATION
McDonnell Douglas Corporation	(1) 3MAR85	Open*	Defective Pricing
	(2) 24AUG84	Open	Cost Mischarging
Rockwell International Corporation	(1) 9JAN85	Open	Cost and Labor Mischarging
	(2) 6MAR84	Open	Cost Mischarging
	(3) JAN85	Open	Cost Mischarging
	(4) MAR85	Open	Cost Mischarging
	(5) 6APR83	Open	Cost Mischarging
General Dynamics Corporation	(1) 22MAR84	Open	Cost Mischarging
	(2) 4APR84	Closed	Subcontractor Kickbacks
	(3) 13FEB84	Open	Labor Mischarging
	(4) 10JUL84	Open	Product Substitution
	(5) 4JAN85	Open	Subcontractor Kickbacks - Cost Mischarging
	(6) 06FEB85	Open	Security Compromise
	(7) 27OCT83	Open	Defective Pricing
	(8) 6APR84	Open	Cost Mischarging
	(9) 6APOR84	Open	Cost Duplication
	(10) 5OCT84	Open	Cost Mischarging
	(11) 28JUN83	Open	Labor Mischarging
	(12) 26APR85	Open	False Claims

*Open in some cases may mean pending action (civil or administrative) other than criminal action.

CONTRACTOR	DATE OPENED	OCT 1, 1985 STATUS	FRAUD OR OTHER ALLEGATION
Lockheed Corporation	(1) 30MAY84	Open	Labor Mischarging
	(2) 27MAR84	Closed	Labor Mischarging
Boeing Company Incorporated	(1) 20AUG84	Open	Cost Mischarging
	(2) OCT84	Open	Supply Accountability
	(3) OCT84	Open	Cost Mischarging
	(4) MAR85	Open	Labor Mischarging
General Electric Company	(1) 15FEB85	Open	Defective Pricing
	(2) JUN84	Open	Labor Cost Mischarging
	(3) OCT84	Open	Product Substitution
	(4) 20JUL83	Open	Labor Mischarging
United Technologies Corporation	(1) 11FEB85	Closed	Gratuities
	(2) 3DEC84	Open	Subcontractor Kickbacks
	(3) 21SEP83	Open	Cost Mischarging
	(4) 22FEB83	Open	Bribery-Subcontractor Kickbacks
	(5) JUN84	Open	Defective Pricing
Raytheon Company	(1) 8APR85	Open	Labor Mischarging
	(2) 21SEP82	Open	Product Substitution
	(3) 13AUG84	Open	Labor Mischarging

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CONTRACTOR	DATE OPENED	OCT 1, 1985 STATUS	FRAUD OR OTHER ALLEGATION
Litton Industries Incorporated	(1) 16FEB84	Closed	Bribery-Subcontractor Kickbacks
	(2) 29FEB84	Open	Labor Mischarging
	(3) OCT82	Open	False Claims
	(4) 19SEP84	Closed	Bid Rigging
	(5) 14JAN85	Open	Cost Mischarging
Grumman Corporation	(1) 14MAR85	Open	Cost Mischarging
Martin Marietta Corporation	(1) 16NOV84	Open	Subcontractor Kickback
	(2) 30SEP82	Open	Cost Mischarging
	(3) FEB85	Open	Cost Mischarging
Westinghouse Electric	(1) 28JUN84	Open	Cost Mischarging
	(2) 16FEB84	Open	Cost Mischarging
	(3, 19MAR84	Open	Cost Mischarging
Sperry Corporation	(1) 27MAR85	Open	Labor Mischarging
	(2) 1JUN84	Open	Cost Mischarging
	(3) 10JAN83	Open	Defective Pricing

CONTRACTOR	DATE OPENED	OCT 1, 1985 STATUS	FRAUD OR OTHER ALLEGATION
Honeywell Incorporated	(1) 26NOV84	Closed	Diversion of Government Property
	(2) DEC84	Open	Bid Rigging
Ford Motor Company	(1) 17JAN84	Open	Defective Pricing-Labor Mischarging
	(2) 17JAN84	Open	Labor Mischarging
	(3) 30SEP83	Open	Labor Mischarging
Eaton Corporation	(1) 18MAR85	Open	Conflict of Interest-Gratuities
	(2) 19MAR85	Open	Cost Mischarging
TRW Incorporated	(1) 15JAN85	Open	Defective Pricing
	(2) 10MAY84	Open	Cost Mischarging
Texas Instruments	14SEP84	Open	Product Substitution
Northrop Corporation	(1) 4NOV84	Open	Labor Mischarging
	(2) 1FEB85	Closed	False Progress Payments
AVCO Corporation	(1) 3DEC84	Open	Subcontractor Kickbacks
	(2) 2AUG83	Open	Cost Mischarging
Textron Incorporated	(1) 1FEB85	Open	Cost Mischarging
	(2) 1JUN84	Open	Cost Mischarging
Allied Corporation	23OCT84	Closed	Conflict of Interest
Tenneco Incorporated	02APR85	Open	Cost Mischarging
GTE Corporation	(1) 5MAY83	Open	Unauthorized Acquisition and Utilization of Classified Data
	(2) 17JUN83	Open	Labor Mischarging
	(3) 30SEP83	Open	Labor Mischarging
Sanders Associates Incorporated	5MAY83	Closed	Unauthorized Release of Contract Information
Motorola Incorporated	2FEB84	Open	Labor Mischarging

CONTRACTOR	DATE OPENED	OCT 1, 1985 STATUS	FRAUD OR OTHER ALLEGATION
Congoleum Corporation	(1) 24OCT84	Open	Mischarging
	(2) 15AUG83	Open	Gratuities/Theft
Harris Corporation	(1) 23SEP83	Open	Defective Pricing
Gould Incorporated	(1) 04APR84	Open	Mischarging
	(2) 26FEB85	Open	Cost Mischarging
	(3) 7JUN85	Closed	Cost Mischarging
	(4) 24APR84	Open	Cost Mischarging
Emerson Electric Company	(1) 23JAN85	Open	Cost Mischarging
	(2) 9JAN84	Closed	Cost Mischarging
	(3) 8FEB85	Closed	Gratuities-Cost Mischarging
Johns Hopkins University	7JUL83	Closed	Champus Fraud
TRACOR Incorporated	23MAR83	Open	Product Substitution
Lear Siegler Incorporated	(1) 2APR85	Open	Product Substitution
Fairchild Industries Incorporated	(1) 5JUL84	Open	Gratuities
	(2) 4NOV83	Open	Product Substitution
	(3) JUL82	Closed	Cost Mischarging
	(4) 13FEB84	Closed	Mischarging, False Statements
Dynalectron Corporation	SEP84	Open	Cost Mischarging
Todd Shipyard Corporation	23JAN85	Closed	Noncompliance with Contract

INSERT FOR THE RECORD

☐ HOUSE ☐ SENATE	APPROPRIATIONS COMMITTEE	☐ HOUSE ☐ SENATE	ARMED SERVICES COMMITTEE	☒ HOUSE ☐ SENATE	OTHER Energy & Commerce
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO	LINE NO	INSERT NO		(From letter) Quest. No. 2

Question 2 (from letter): At the April 24 hearing, you were asked to furnish the Subcommittee with your thoughts and suggestions for improving the defense procurement system. You indicated that, as the Inspector General, you were independent and could tell us what you thought. In a letter dated June 14, 1985, signed by Mr. Vander Schaaf, he indicated that your thoughts and suggestions were not available at that time. Mr. Vander Schaaf indicated that the recommendations that you have made are now being considered by the Secretary of Defense and that only after decisions are made on these suggestions, will your thoughts and suggestions be furnished to the Subcommittee. This response is highly curious. The Subcommittee is interested in your thoughts and suggestions, not those of Secretary Weinberger or other defense officials. Were you instructed not to furnish your thoughts and suggestions to the Subcommittee? The Subcommittee would appreciate being furnished with your thoughts and suggestions or with an explanation as to why such information cannot be furnished.

Answer: No one instructed me to withhold my thoughts and suggestions from the Committee. As Mr. Vander Schaaf indicated, I was formulating and testing my suggestions for improving the Defense Procurement process with the Defense Council on Integrity and Management Improvement (DCIMI) and was engaged in a continual dialogue with other key DoD officials in putting together my final thoughts and suggestions. I believe that the Departments managers who are responsible for executing any changes I recommended to the procurement process should have an opportunity to comment on my proposals before they were considered final and transmitted beyond the Department.

That DCIMI consideration culminated in a series of final decisions on August 29, 1985. Many of my suggestions were adopted by the DCIMI and the Secretary. Others were adopted in the Conference Report on the FY 1986 DoD Authorization.

Enclosed at Tab A is a set of 37 recommendations developed from those I presented to the DCIMI last spring and summer. The DCIMI or the conference report has approved and begun implementation of 25 of the recommendations.

I believe the remaining 12 recommendations should also be implemented, and I have made my views on these known to the Blue Ribbon Commission on Defense Management.

INSERT FOR THE RECORD								
	HOUSE	APPROPRIATIONS COMMITTEE		HOUSE	ARMED SERVICES COMMITTEE	X	HOUSE	OTHER Energy & Commerce
	SENATE			SENATE			SENATE	
HEARING DATE April 24, 1985	TRANSCRIPT PAGE NO		LINE NO		INSERT NO			(From Letter) Quest. No. 3

Question 3 (from letter): As you know, some contractors have raised questions about the accuracy of the list of open Department of Defense investigations involving the top 100 defense contractors that you furnished the Subcommittee on June 14. We are, therefore, requesting the following information regarding the open investigations involving the 36 contractors listed: the date the case was opened; the source of the allegation; the substance of the allegation; identification of the division under investigation; the current status of the investigation; and any additions or deletions to the list subsequent to its preparation.

Answer: I have enclosed at Tab B the following information relative to an update of the list of 36 previously provided to the Committee:

- o date the investigations involving these contractors were opened
- o current status of these investigations
- o character of the allegation involved in each investigation.

In order that I protect the confidentiality of sources, I cannot provide specific identification data on each case. Generally, the source of the allegations discussed were audit referrals and confidential informants.

FOR OFFICIAL USE ONLY

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

23 JAN 1986

RECEIVED
JAN 23 1986
Subcommittee on Oversight and Investigations

Honorable John D. Dingell
Chairman
Subcommittee on Oversight and
Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciate the continuing interest of your Subcommittee in the role of the Inspector General and other Department of Defense investigative agencies in connection with major Defense contractors.

My letters of November 18, 1985, and December 6, 1985, responded to all but one of the questions posed in your letter of October 1, 1985. The final question deals with Significant Incident Reports, and I am enclosing my response based on an agreement between our respective staffs that redacted copies are acceptable. These copies do not contain names of individuals or subjects unless the investigation has reached indictment or has resulted in conviction.

The material in the enclosure contains information on open criminal investigations and should not be publicly released. We deem it prudent to open criminal investigations based upon allegations and supporting information provided from various sources. We treat this information as nonjudgmental with a presumption of innocence for those involved. Accordingly, the information is provided for the use of the Subcommittee only.

I am sending a copy of this letter and its enclosures to Representative Broyhill, Ranking Minority Member of the Subcommittee.

Sincerely,

Derek J. Vander Schaaf

for Joseph H. Sherick
Inspector General

Enclosures

(Note: Enclosures may be found in subcommittee files.)

FOR OFFICIAL USE ONLY

Mr. **Wyden**. We have votes on the floor with respect to the Nicaragua legislation, so we will reconvene in 20 minutes.

Mr. **Sherick**. I have some Hotline posters and some Hotline cards that I would like to leave up here for people.

Mr. **Wyden**. Thank you very much.

[Brief recess.]

Mr. **Wyden**. The subcommittee will come back to order.

Our next witness will be Mr. Charles O. Starrett, Director, Defense Contract Audit Agency, Building 4, Cameron Station, Alexandria, VA.

Mr. Starrett, we appreciate your patience. It has been a long day and we appreciate your staying.

We have the matter of the Nicaragua legislation on the floor, and I believe before our next vote, we will be able to complete your testimony. So we welcome you.

Let me advise you it is the practice of the subcommittee to swear all witnesses. Do you have any objection to being sworn?

Mr. **Starrett**. No, I don't.

Mr. **Wyden**. Please rise.

[Witness sworn.]

Mr. **Wyden**. Mr. Starrett, we will make a copy of your prepared remarks a part of our hearing record and if you would summarize your principal concerns this afternoon in the interest of time, I think that would be most helpful.

TESTIMONY OF CHARLES O. STARRETT, JR., DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

Mr. **Starrett**. I appreciate the opportunity to appear before you and discuss the role of DCAA in assuring that Government contractors are paid only for allowable, allocable and reasonable overhead costs.

I would like to begin by giving you some background about DCAA. The Agency's mission, as stated in DOD Directive 5105.36, is to perform all necessary contract audit for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all Department of Defense components responsible for procurement and contract administration.

DCAA employs approximately 4,100 people in over 420 offices throughout the Continental United States and overseas. About half of our employees work in area offices located in large metropolitan areas, and the other half work full-time at the plants of the larger defense suppliers.

DCAA is basically a one-occupation agency. Over 80 percent of all employees are professional accountants and auditors. Of the accounting and audit staff, 96 percent are college graduates and 25 percent are certified public accountants.

Last year, DCAA set all-time records in productivity improvement, audit coverage and savings for the taxpayers. During 1984, DCAA realized net savings to the taxpayers of approximately $7.5 billion. When compared to the Agency's operating costs of $159 million, this yields $48 in taxpayer savings for each dollar spent. This level of savings represents a substantial contribution to the total audit savings within the Federal Government.

Last year we examined approximately 28,000 contractor pricing proposals worth $273 billion, a dollar increase of 16 percent over 1983. An additional $47 billion in contractor-incurred cost claims were audited. Total costs questioned by DCAA auditors increased 16 percent above the 1983 performance.

With regard to overhead expenses, the Federal Acquisition Regulation, generally accepted accounting principles and cost account standards comprise the guidelines used by DCAA in determinining the allocability and reasonableness of contract costs.

The FAR requires a contractor with flexibly priced contracts to submit a claim within 90 days after the end of its fiscal year or by a later date approved by the contracting officer. The claim is submitted to the cognizant DOD contracting officer responsible for negotiating its final overhead rates.

For General Dynamics, this would include at least six separate overhead cost submissions, one from the corporate office and one from each of the five major divisions involved in government contracting.

The claim is audited by DCAA and an audit report is prepared and issued to the cognizant administrative contracting officer setting forth our audit recommendations.

Submission of the incurred costs overhead claim is the point at which we can tell if a company is claiming certain expenses that are recorded on their books.

Mr. **Wyden**. Mr. Starrett, excuse me. Two things. We have heard a great deal of testimony on the way the system works, and we will make a copy of your prepared remarks a part of the record; particularly in the interest of time, if you could just summarize some of your principal concerns, that would be most helpful.

Mr. **Starrett**. Well, essentially, the rest of the summary says that in developing overhead rates, we put a factor on them, and that factor takes care of a lot of the expressly unallowable, if not all of the expressly unallowable costs that defense contractors have on their books.

There are other expenses that are unreasonable and are found by the Defense Contract Audit Agency in our review of these claims.

Some of the concerns that your staff asked me about related to cost accounting standards. For example, whether or not we find the contractors are complying with cost accounting standards is one of the questions. I think earlier today the GAO has testified that there is a problem with what is considered to be expressly unallowable costs, which complicates that particular cost accounting standard; and I want to second the motion that GAO and, as I recall, Joe Sherick both suggested, and that is that there be a Cost Accounting Standards Board.

I think we are long overdue for a Cost Accounting Standards Board that will address some of these questions.

In looking at the rest of the statement, in view of the fact that it will be in the record, I would like to point out one other thing, and that is that in the advisory role that we have in the Department of Defense, and in accordance with our charter, we provide contracting officers with what we consider to be the most professional auditing and accounting advice.

Last year we had 74 percent of cost question sustained rate in the incurred cost area. That would include overhead. And in the forward pricing proposal review area, we were sustained 64 percent of the time. I think that that 64 percent is quite good when you consider that we are talking about judgments on what costs will actually be in the future.

We have had some problems with General Dynamics on access to records. We do not have any problems at the present time.

With that, I think I will just go on to questions.

[Testimony resumes on p. 671.]

[The prepared statement of Mr. Starrett follows:]

STATEMENT OF
MR. CHARLES O. STARRETT, JR.
DIRECTOR
DEFENSE CONTRACT AUDIT AGENCY

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear before you to discuss the role of DCAA in assuring that Government contractors are paid only for allowable, allocable, and reasonable overhead costs.

I would like to begin by giving you some background about DCAA. The Agency's mission, as stated in DoD Directive 5105.36, is to: Perform all necessary contract audit for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all Department of Defense components responsible for procurement and contract administration.

DCAA employs approximately 4,100 people in over 420 offices throughout the continental United States and overseas. About half of our employees work in area offices located in larger metropolitan areas, and the other half work full-time at the plants of the larger defense suppliers.

DCAA is basically a one-occupation agency--over 80 percent of all employees are professional accountants and auditors. Of the accounting and audit staff, 96 percent are college graduates, and 25 percent are certified public accountants (CPAs).

Last year DCAA set all-time records in productivity improvements, audit coverage, and savings for the taxpayers. During 1984 DCAA realized net savings to the taxpayers of approximately $7.5 billion. When compared to the agency's operating costs of $159 million, this yields $48 in taxpayer savings for each dollar spent. This level of savings represents a substantial contribution to total audit savings within the Federal Government. Last year we examined approximately 28,000 contractor pricing proposals worth $275 billion, a dollar increase of 16 percent over 1983. An additional $47 billion in contractor incurred cost claims were audited. Total costs questioned by DCAA auditors increased 16 percent above 1983 performance.

With regard to overhead expenses, the Federal Acquisition Regulation (FAR), Generally Accepted Accounting Principles (GAAP), and Cost Accounting Standards (CAS) comprise the guidelines used by DCAA in determining the allowability, allocability, and reasonableness of contract costs.

The FAR requires a contractor with flexibly-priced contracts to submit a claim within 90 days after the end of its fiscal year, or by a later date approved by the Contracting Officer.

The claim is submitted to the cognizant DoD Contracting Officer responsible for negotiating its final overhead rates.

For General Dynamics, this would include at least six separate overhead cost submissions, one from the Corporate Office, and one from each of the five major Divisions involved in Government contracting.

The claim is audited by DCAA and an audit report is prepared and issued to the cognizant Administrative Contracting Officer setting forth our audit recommendations.

Submission of the incurred cost overhead claim is the point at which we can tell if a company is claiming certain expenses that are recorded on their books. In other words, there are usually many unallowable expenses recorded on Government contractor books, but until we get the claim, after the fiscal year is over, we will not know if they are, in fact, going to be claimed.

Before continuing to describe our procedures, let me address the expenses that have been highlighted in your hearings concerning General Dynamics, and expenses of other companies that have been detailed in various news accounts. With few exceptions, where the contractor has claimed these expenses we have appropriately questioned these costs. With regard to General Dynamics, we do not have a claim for fiscal year 1984 overhead as yet, therefore I can't address the expenses related to 1984 such as dinner parties, golfing weekends, and club dues. Our audit of fiscal year 1983 is not yet complete, but I assure you we are aware of, and will appropriately address each item.

Your staff asked that I comment on contractors' compliance with Cost Accounting Standard (CAS) 405, "Accounting for Unallowable Costs."

It is our opinion that contractors, in general, do comply with CAS 405 which provides that "costs expressly unallowable . . . shall be identified and excluded from any billing, claim or proposal applicable to a Government contract." During the course of audits we find circumstances in which there are differing opinions between DCAA and contractors as to what constitutes an "expressly unallowable" cost. An example of this would be an account entitled "Business Meetings," in which a contractor might include costs for boarding a dog, or babysitter expenses. The contractor could contend that these costs were both necessary and coincidental to the attendance of a business meeting. DCAA, of course, would question these costs as personal expenses. However, whether they are "expressly unallowable" or not is a technical question unrelated to the fact that we won't pay. The fact that these circumstances occur in which agreement can not be obtained as to the definition or constitution of an "expressly unallowable" cost, highlights the need and urgency for reestablishing the CAS Board.

Going back to our procedures, the next logical question is how do companies get paid for overhead expenses. Since Government contracts provide for interim reimbursement, it is necessary to negotiate overhead rates to be used on an interim basis. This negotiation takes place before the contractor's fiscal year begins, and overhead rates are forecasted based on past experience. The negotiator takes into account, not only the actual rates incurred last year, but deducts an estimate of unallowable expenses for the current year. These rates are monitored and subject to change during the year. After the close of the year, adjustments are to be made based on a comparison of the total amount billed (and paid) with the amount forecasted to be allowable after final negotiation. The intent of this procedure is to make sure the Government does not pay for improper overhead expenses even if claimed by the contractor.

The application of this procedure has resulted in $90 million of General Dynamics overhead costs never being paid and covers such items as dog kennels, entertainment, etc.

With regard to DCAA's role and relationship with contractors, the nature of the auditing profession places a distinct responsibility on its employees to maintain a professional attitude in their day-to-day dealings with contractor personnel. DCAA personnel are expected to exercise tact and diplomacy in their relationships not only with contractor personnel but other governmental agencies as well. Above all, DCAA auditors are required to maintain an independent and objective frame of mind in reviewing contractor books and records. This professional attitude is both necessary and required as our auditors must never allow themselves to be put in a compromise situation with Government contractors.

In order to assure that our auditors' independence is maintained, we closely monitor auditor assignments and personal financial interests to avoid or minimize any potential conflicts of interest. We also have an effective auditor rotation policy that promotes independence by transferring resident office managers and supervisors to new contractors every five years.

Auditors are also required to familiarize themselves with the Standards of Conduct (DAR 1-113) every six months.

DCAA serves in an advisory role to the Contracting Officer. In general, DCAA has been able to obtain good support from cognizant contracting officer in the resolution of accounting issues. Following are some statistics for our two major areas of work, indicative of the overall support we have been given:

Audit Review	Percentage of Costs Questioned Sustained
Incurred cost	74
Forward pricing	64

You asked me to comment on our access problems. The nature of the auditor's work requires that he or she accumulate sufficient evidential matter in order to provide a reasonable basis for an opinion. This need for documentation frequently leads to a confrontation as to what contractor documents should be made available to the auditor. These confrontations are met and solved every day by open discussion between the contractor and DCAA personnel. If in a particular audit of incurred costs we feel that the lack of access to certain documentation has prevented us from forming an informed opinion of the reasonableness, allowability, or allocability of the costs, we will withhold payment under cost-type contracts if not resolved in a reasonable time frame. If this is not persuasive, we will request a subpoena from the IG. If we run into an access problem that we can't solve while reviewing a price proposal, we so state in our audit report. These qualifications are explained in the report and are addressed during subsequent negotiations.

In the past we have had access problems to both records and personnel at General Dynamics locations. This was a particular problem during the General Dynamics Washington Office audit conducted in 1975. The access problem was easily resolved by our questioning the Washington Office expenses in total. Later, we had a misunderstanding concerning the General Ledger. This problem was resolved rather quickly when we suspended payment of several million dollars.

Presently I do not know of any access problems we have at General Dynamics.

DCAA has taken an active role in the promulgation of revisions to the Defense Acquisition Regulations (DAR), particularly in the area of the unallowability of costs under the cost principles contained in DAR-15. There are several avenues open to DCAA to effect improvements in acquisition regulations and cost principles. These include:

- Submission of recommendations for FAR changes to the DAR Council.

- Direct participation on various DAR and CAS committees and subcommittees.

- Presentation of issue papers to the Comptroller for Secretarial action.

- Submissions of recommendations for changes to the Cost Accounting Standards to the DoD CAS Policy Group.

Following are some examples of recommendations which were initiated by DCAA:

Case No. 82-76, Compensation for Personal Services, DAR 15-205.6(m), Fringe Benefits (Banked Vacations)

A DCAA memorandum dated 3 June 1982 to the DAR Council recommended a revision to DAR 15-205.6 to require contractors to discount vacation costs when there is a long time between the time they are earned (and charged to Government contracts) and the time they are taken. The objective is to deny contractors interest-free use of Government funds.

Case No. 83-62, Compensation for Personal Services, DAR 15-205.6(i), Discounts in Employee Stock Purchase Plans

A DCAA memorandum dated 14 March 1984 to the DAR Council recommended revision of DAR 15-205.6(i) to disallow discounts on stock issued to employees under employee stock purchase plans when such discounts are not treated as cost in the contractor's financial statements. The issue arises out of an ASBCA decision that allowed such discounts.

Case No. 84-144, Public Relations

A DCAA memorandum dated 15 May 1984 to the Assistant Secretary of Defense (Comptroller) recommended initiation of a study to determine whether public relations (PR) activities benefit DoD contracts and whether there is a need to establish thresholds on the reasonableness of PR costs, and to develop a DoD policy on the allowability of PR costs. ASD(C) referred the matter to OUSDR&E, who requested the DAR Council to consid issuing a cost principle on PR. The 1 November 1984 report the Cost Principles Subcommittee recommended PR coverage f incorporation into FAR 31.205-1, Advertising. The Counc published for comment the Subcommittee's recommended coverag Comments to the FAR Secretariat were due on or before 22 Apr 1985.

Case No. 79-45, DAR 15-205.9, Depreciation, and DAR 15-205.3 Rental Costs

A DCAA memorandum to the DAR Council dated 26 April 19 advised that FASB 13, which had recently been adopted into t cost principles, permitted leases to be structured so as to avo capitalization. By so doing, contractors could circumvent t Government's intent to allow ownership cost only for leases th are in substance purchases. DCAA recommended that DoD return the prior regulations that permitted only ownership costs f assets defined as long-term.

Case No. 83-43, Goodwill

In August 1983, DCAA advised the Assistant Secretary Defense (Comptroller) of an ASBCA decision that would result significant amounts of previously unclaimed goodwill being charged to Government contracts. ASD(C) recommended to USDR&E that a cost principle be promulgated making goodwill unallowable. The Cost Principles Subcommittee completed its work on 22 August 1983, and the goodwill cost principle was promulgated on 25 February 1984.

Case No. 80-140, Payment of Legal Costs Under DAR 15-205.31(d)

A DCAA memorandum to OUSDR&E dated 23 October 1980 recommended that DAR 31-205.31(d) be revised to make unallowable all legal and related costs directly associated with the incurrence or investigation of a specific offense, where fraud or other irregularity is involved, as well as all litigation costs related to civil actions, except when the litigation is approved by the contracting officer. Included as an enclosure to the DCAA memorandum was a schedule of legal costs reported by DCAA regions relating to Grand Jury and other Government investigations showing total costs of over $20 million. The memorandum was referred to the DAR Council, and ultimately to the Cost Principles Subcommittee where it was considered along with similar proposals from other DoD components under DAR Case No. 80-140, which resulted in a new cost principle, DAR 15-205.51, Defense of Fraud.

Your letter also asked that I comment on the DCAA audit findings contained in our Audit Report No. 2360-4R105100, dated 19 October 1984, Evaluation of Shipyard Productivity, General Dynamics Corporation, Groton, Connecticut, and the actions DCAA has taken with the cognizant Contracting Officer. With your permission, I would rather decline public comment at this time since these findings have a potential impact upon the current TRIDENT V negotiations.

This concludes my prepared statement and I would be pleased to answer any questions the Members might have.

Mr. Wyden. Thank you, Mr. Starrett. We are very appreciative of your summarizing your concerns. As I said, your statement will appear in its entirety in the record.

Let me begin by asking this. David Lewis, the CEO of General Dynamics, dismissed DCAA auditors as mere, in his words, advisers, and really not individuals in the decision-making process.

Mr. Lewis also said that history shows that very little of DCAA findings or cost questions are ever sustained in the negotiations.

Why would Mr. Lewis make this kind of statement? I gather you don't agree with that.

Mr. Starrett. I most certainly do not.

Mr. Wyden. Why would he make such a statement?

Mr. Starrett. I really don't know. As far as history is concerned, I think that in about 1981, we got concerned about sustention rates ourselves, and one of the things that I have pressed real hard on in the Defense Contract Audit Agency was for auditors to go to negotiations, that there were negotiations taking place and we were not there. We were not there to speak to our findings and respond to the responses of the contractors, and this was not, in my opinion, a good way to go. We were losing something in the process.

Mr. Wyden. But Mr. Lewis is basically right. I mean if you look just at this question of Mr. Modesitt that we have been looking at—I believe you are aware of the hearings held the last few days—isn't that a pretty good example of Mr. Lewis being right?

Mr. Starrett. I am quite familiar with Mr. Modesitt, yes, and that was a tri-Service negotiation arrangement that was done away with some time ago. I think since then we are doing a lot better than we used to do in those days.

Mr. Wyden. The General Accounting Office seemed to say this morning that this was not that uncommon to have situations like Mr. Modesitt. You are saying that that wouldn't happen in today's system?

Mr. Starrett. Oh, no, I did not say that at all. I simply said things are getting better. I think if you go back prior to 1981, for example, why, you will find that our history and our statistics will show that we were supported in the incurred cost area probably around 52 or 53 percent of the time, and now we have worked that up to 74 percent.

My only point is that we have been working very hard on that, and there are a number of reasons why, and I would like to advise you of those, if you would like. One of them, as I mentioned, was that we have been pressing real hard to attend negotiations, and we become more effective when our auditors are there and they can speak to the findings.

Second, we have been working on cost principles. There have been voids in cost principles, there have been areas subject to misinterpretation, and we have been working on suggesting many different cost principles be tightened up.

Mr. **Wyden**. If you attend these negotiations, is that any problem from the standpoint of your independence? I mean it would seem to be hard to criticize ACO's at that point, wouldn't it?

Mr. **Starrett**. Oh, I think we would get right in and tell the contracting officer, as we do right now, that we don't agree with that; that we think you ought to sustain this finding and do this, that and the other thing. And that is part of the approach to establishing the Government's team, a negotiation objective.

Mr. **Wyden**. Did you and others complain to Mr. Modesitt? Did he try to do something about it when you complained to him?

Mr. **Starrett**. Oh, as I understand it, there was a letter written by a DCAA auditor that was read yesterday in the hearing.

Mr. **Wyden**. That is correct, as we understand it, but did it go up to your level and did you try to do something about it?

Mr. **Starrett**. I was not the director at the time. I don't know what exact year this took place.

Mr. **Wyden**. I understand it took place in 1981.

Mr. **Starrett**. Well, I became the director in the middle of 1981.

Mr. **Wyden**. How many people do you think are out there today, out there on the front lines like Mr. Modesitt? I asked you if this situation had been cleaned up so there was nobody left like that, and you said no. How many people are there still out there like Mr. Modesitt?

Mr. **Starrett**. I don't even know how many people there are out there in that capacity, but I am familiar with the old tri-Service approach, and that approach was phasing out at the time that Mr. Modesitt was there, and the change was made to have a local contract administrative officer negotiate the overheads at the various locations. In other words, it was decentralized.

So now we have contracting officers at the various locations. For example, at General Dynamics there are six contracting officers that are involved in deciding what the overhead rates will be for General Dynamics.

Mr. **Wyden**. Are the contractors complying with the cost accounting standard establishing and using unallowable accounts? We are talking here about Standard No. 405.

Mr. **Starrett**. The question of compliance with that cost accounting standard has to do with whether or not costs are expressly unallowable. The definition of expressly unallowable is that they are costs that are succinctly described in the cost principles, such as advertising, bad debts, and things like that.

With things like advertising and bad debts, there is not much of a problem, and we are not having any real large noncompliance problem.

Mr. **Wyden**. General Dynamics didn't even have such an account until a year ago.

Mr. **Starrett**. That's correct. That's one of the concerns we had, and the reason that they started setting it up was because we were complaining about their not accumulating unallowable costs.

Mr. **Wyden**. Why did DCAA let that go on since the mid-seventies?

Mr. **Starrett**. Well, I don't know that it went on since the mid-seventies.

Mr. **Wyden**. They had no such account, as I understand it, at DCAA headquarters from the mid-seventies to the date I identified.

Mr. **Starrett**. Well, I can't answer that question. I don't know the answer.

Mr. **Wyden**. But you believe that the contractors are today complying with Cost Accounting Standard 405?

Mr. **Starrett**. Well, that is not exactly what I am saying. What I am saying is that the cost accounting standard as written is very easy to comply with. You can have unallowable costs that you don't segregate, but it is very difficult to get them into the category of expressly unallowable, and therefore I think we need the cost accounting standard definition of "expressly unallowable" changed.

As a matter of fact, on the subject of Cost Accounting Standard 405, I think it would be well if we were to put some kind of a penalty in there because there is no penalty if a company does not follow Cost Accounting Standard 405. The only penalty in there, and it is not even labeled a penalty, is the interest on the money, and that is a very low rate, 7 percent, as was mentioned.

Mr. **Wyden**. So you are saying either by legislation or, if legally possible, by administrative regulation, we should rewrite the rules with respect to these accounts and put in stiff penalties.

Mr. **Starrett**. Yes, sir.

Mr. **Wyden**. Why, at this point, do the contractors, particularly General Dynamics, which we have looked at, play this "catch me if you can" kind of game with DCAA?

Mr. **Starrett**. Well, I think one of the problems with General Dynamics is that we have not had settlements in many of the locations. There are a number of complicated problems that have kept the overhead rates open for long periods of time, and until you can get the company to the table and sit down and go over what is in a claim and start negotiating it, you can go for several years and get claims that are the same as they were before.

And I really believe that we need to get General Dynamics to the table and we need to get the contracting officers to the table and start settling some of these things. And that's one of the reasons that we recently took the very stiff position with General Dynamics by withholding $154 million more than we had held before.

Mr. **Wyden**. Mr. Starrett, in your testimony on page 4 you said, and I quote here, "During the course of audits, we * * *."—being DCAA, of course,—"* * * find circumstances in which there have been differing opinions between DCAA and contractors as to what constitutes an expressly unallowable cost." And the example that was given, of course, was a business meeting in which a contractor might include costs for boarding a dog or babysitter expenses.

My question to you is: Is the DAR, the Defense Acquisition Regulation, is it so ambiguous that the contractor believes—believes, now—that the Government would pay for dog boarding?

Mr. **Starrett**. I can't speak for the contractor. The point of that part of my prepared comments is that there is nothing in the DAR right now that says, No. 1, dog kennel costs are unallowable. It is not that specific. I'm not suggesting that it should be. There's nothing in the DAR that says personal expenses are unallowable. And that's exactly what this is, in my opinion; we would never pay it.

But the question of whether or not you could then institute Cost Accounting Standard 405 because it's an expressly unallowable cost gets muddied.

Mr. **Wyden**. So at present, the way these Defense Acquisition Regulations are written, you can claim anything under these accounts.

Mr. **Starrett**. No.

Mr. **Wyden**. What couldn't you claim? Give me an example of something you couldn't claim, because I can't find any examples.

Mr. **Starrett**. Well, advertising costs. Other than advertising for scarce materials or help wanted. Bad debts. Contributions.

Mr. **Wyden**. And you can get around that by some kind of little "help wanted" kind of tag.

Mr. **Starrett**. No; I don't think that really works. I've heard that story, but we wouldn't allow that.

Mr. **Wyden**. I think it's clear from hearings held by the Brooks Committee and the GAO testimony that you can.

Mr. **Starrett**. We testified at those hearings, and the point of that testimony and the entire hearing was that we were of the opinion that we needed a public relations cost principle. And there has been some testimony regarding that cost principle earlier in these hearings.

Mr. **Wyden**. But that's not in effect today.

Mr. **Starrett**. That cost principle is not in effect. The Federal Register had—the date for comments to come in under the Federal Register was April 22, I believe. So comments have to be looked at.

Mr. **Wyden**. If that goes into effect maybe we can turn it around. But as of now, I don't see anything that couldn't be claimed under the DAR today.

Mr. **Starrett**. Well, as I say, there are many things that should not be claimed.

Mr. **Wyden**. That you should not claim, but——

Mr. **Starrett**. Well, you would either run into Cost Accounting Standard 405 or you would run into DCAA. So it's one or the other.

Mr. **Wyden**. But once you claim them, though—and you have not given me an example of something you can't claim—then you start getting progress payments and you are already on the way to doing pretty darned well, at the taxpayers' expense.

Mr. **Starrett**. I'm afraid that isn't so.

The point of the testimony that I was going to give is that when we established the billing rates at the beginning of the year those billing rates are established based on what we consider to be the amount of allowable costs.

In the case of General Dynamics, for example, there are several million dollars that they have on their books——

Mr. **Wyden**. Excuse me. Isn't that built into the billing rates from prior years, though?

Mr. **Starrett**. No.

Mr. **Wyden**. All those uncertainties are not built in?

Mr. **Starrett**. No. As a matter of fact, $90 million has never been paid to General Dynamics, and we just recently asked for $154 million back. That $154 million is for covering such very, very technical issues as workmen's compensation, amortization of electronic data processing costs and things like that.

But as far as dog kennels and the rest of it, those were in the $90 million that we never paid General Dynamics.

Mr. **Wyden**. But it seems to me if you don't catch those early—and we are not—and throw them out, it gets built into the billing rates.

Mr. **Starrett**. Well, that could be true. However, we have $90 million—and that is a fact—of General Dynamics' money, and it is for that purpose.

Mr. **Wyden**. And we would agree, of course, that that wasn't until recently.

Mr. **Starrett**. No, I'm sorry, sir. That $90 million was never paid to General Dynamics.

Mr. **Wyden**. But it is still not enough to cover the questioned costs.

Mr. **Starrett**. It doesn't cover all the questioned costs, and that's why we took another $154 million. But the $154 million is related to very technical issues.

Mr. **Wyden**. Well, all this is very technical, and that, of course, is the problem. What we are seeing is these kinds of technicalities are allowing contractors particularly General Dynamics, to throw everything but the kitchen sink into these accounts, and a whole host of items that have no relation to the national defense.

Mr. **Starrett**. I agree with you 100 percent as far as claiming the cost. They are in the claims. My only point is that the way that we go about setting billing rates in the Department of Defense does not mean that we paid the amount they claimed. And when we recently went through the entire number of years that are open, we found that we have not paid them $90 million that they might otherwise, if they weren't unallowable, get.

Mr. **Wyden**. Wasn't the disallowance billing rate only 4 percent when the subcommittee started and now it is 14 percent?

Mr. **Starrett**. I think that that includes some of the executive aircraft costs which we had been questioning for years.

Mr. **Wyden**. You are questioning 30 percent of the costs?

Mr. **Starrett**. No, I don't recognize that number.

Mr. **Wyden**. Will you get back to us in writing on that point? We are not aware that it includes the corporate aircraft, and we do not think it does.

Mr. **Starrett**. I will have to look into that.

Mr. **Wyden**. Mr. Starrett, I'm very sorry, I have to run and vote. We appreciate your patience, and I will be back here within 10 minutes and we will complete your testimony. And we thank you for your indulgence. I have a floor vote.

[Brief recess.]

Mr. **Wyden**. The subcommittee will come back to order.

Mr. Starrett, again, our thanks for your patience. I am advised that the next vote won't be for 2 hours, so we are going to finish this under any circumstances.

Mr. **Starrett**. Good.

Mr. **Wyden**. Mr. Starrett, when was the last time that you audited executive salaries at General Dynamics?

Mr. **Starrett**. The Defense Logistics Agency was delegated the authority and the responsibility for reviewing compensation at major defense contractors about 1½ years ago. Maybe a year ago, somewhere around that timeframe.

We have been in that area, frankly, considered to be interlopers, I guess you might say. But we feel that we have a responsibility in that area.

Mr. **Wyden**. Have you had access problems in that area? I mean, you mentioned interlopers—that is a word that connotes certain things.

Mr. **Starrett**. No, no, we have not had access problems with General Dynamics. The interloping refers to the fact that the Defense Logistics Agency has scheduled compensation reviews, including executive compensation, and we have been involved in the same area.

Mr. **Wyden**. I want to make sure—you have had no problems with respect to access throughout the contractor community in this area of salaries and executive compensation and labor rates? I don't want to put these words in your mouth and I want you to describe to us——

Mr. **Starrett**. Well, there's very little you can say that is that general. We have had problems. You said General Dynamics.

Mr. **Wyden**. Who have you had problems with?

Mr. **Starrett**. Oh, we had a problem when Mr. Spanton was at Pratt & Whitney in West Palm Beach, and I think when we got up to about $26 million, why, they finally decided that we could obtain the information; we could have it.

Mr. **Wyden**. Did you hold up progress payments to get it?

Mr. **Starrett**. Yes, we were holding approximately $26 million I think at the time that Pratt & Whitney finally decided they would provide us with executive compensation information.

Mr. **Wyden**. Why don't you submit for the record the last report you did with respect to executive salaries at General Dynamics.

Mr. **Starrett**. On General Dynamics?

Mr. **Wyden**. Yes. When was that? I mean, you said, or I gathered that you said, that a report was done.

Mr. **Starrett**. No, I did not.

Mr. **Wyden**. You said you had audited it.

Mr. **Starrett**. No. I said we were considered, and are considered, interlopers in the area, and that we are moving into that area. We do not have executive compensation reviews of General Dynamics that I know of, but if there are, I will certainly provide them for the record.

Mr. WYDEN. We asked you about access problems. You said you had none. And I think any reasonable person would take that to mean that you then went forward and did it.

Now, I want to make sure I've got this. You have done no audits of the salaries at General Dynamics?

Mr. STARRETT. Of the executive compensation you said. There's a difference.

Mr. WYDEN. Executive compensation.

Mr. STARRETT. Yes. Because if you had not said executive compensation I would have answered differently.

Executive compensation is an extremely difficult area. I'm not sure whether we have done any reviews in that area. And I have also mentioned, as I said, that the Defense Logistics Agency has been assigned the DOD responsibility for reviewing those. However, we may have done some reviews of executive compensation, and if so, I will provide them.

Mr. WYDEN. So for all these years, nobody has been reviewing these executive compensation arrangements.

Mr. STARRETT. No, I wouldn't say that.

Mr. WYDEN. Well, who has? And why is it so difficult?

Mr. STARRETT. I would say that the Defense Logistics Agency has been doing reviews of executive compensation. I will find out who and provide you with whatever it is that was done.

Mr. WYDEN. Mr. Starrett, that strikes me as a pretty fundamental thing to a successful audit, to be able to look at executive compensation arrangements. As of now, you're not doing it. You think somebody else is doing it, but I don't see any evidence it's getting done.

Mr. STARRETT. Well, I'm simply telling you what it is I know about General Dynamics in that area, and there may be a lot of things that have been done that I don't know about.

Mr. WYDEN. What about other contractors then, and audits of their executive compensation?

Mr. STARRETT. We have been doing executive compensation audits from the standpoint of forward pricing agreements and looking at what it is the company has in the way of labor rates and parts of pensions.

For example, we look at pension costs, insurance costs. And these are programs that we have that go on continuously.

Mr. WYDEN. You have done this for major contractors?

Mr. STARRETT. Yes.

Mr. WYDEN. Why don't you submit that information for the record?

Mr. STARRETT. OK.

Mr. WYDEN. Have you and the DCAA made any attempts to change the Defense Acquisition Regulation? You have mentioned that it needs to be changed. Everybody has mentioned they felt changes were needed. Have you made any attempts?

Mr. STARRETT. Yes, sir, we have.

Mr. WYDEN. Please describe your efforts.

Mr. STARRETT. Let's start with public relations. We recommended in 1972 that there be a cost principle on public relations. We again recommended, as I recall, in 1978, that there be one; twice I believe in 1978 we recommended that there be a cost principle on public relations and again in early 1984.

Mr. Wyden. What happens to these things? You know, we hear about these recommendations and nothing happens.

Mr. Starrett. Well, in the case of the first three, they went to the Armed Services Procurement Regulations Committee and they established—and they have a standing section 15, or they had a standing section 15 subcommittee. That subcommittee considered all the reasons why we believed there should be a cost principle on public relations, and essentially the conclusion was that everything that might be involved in public relations was otherwise covered by some other cost principle. And that was the conclusion of that group.

Mr. Wyden. Is that your conclusion?

Mr. Starrett. No, it was not. And I think it's quite evident we have been very persistent in trying to get a cost principle on public relations.

Mr. Wyden. How about corporate aircraft? My understanding is that there were proposals to essentially limit contractor billings to DOD for corporate aircraft a decade ago, and those still haven't been adopted.

Mr. Starrett. My information is the same. That's correct.

Mr. Wyden. And you all have pushed and pushed hard to get those adopted?

Mr. Starrett. We have worked on corporate aircraft costs for years. I remember 15 years ago we did a study on corporate aircraft costs, and we are very concerned about that area.

Mr. Wyden. Why do you think it hasn't been changed?

Mr. Starrett. Well, I think they are changing. And I think you will find throughout my testimony that there is one theme I will continue to make, and that is since 1981 I believe things are getting better and better, and I think things are getting tighter and tighter. And we have been able to accomplish quite a bit since 1981.

Mr. Wyden. I haven't seen any changes with respect to the corporate aircraft policy.

Mr. Starrett. There is a cost principle that is practically on the street.

Mr. Wyden. But you know, I keep hearing that these things are practically on the street and there are proposals and it reminds me an awful lot of the marquee at the old movie house where it says, "coming soon" but it never quite gets there. And in the process, of course, the taxpayers are out millions and millions of dollars.

So what you're saying—now I want to make sure I get this—this corporate aircraft change, this proposal, which has been out there for a decade is now practically on the street?

Mr. Starrett. No. I mean there were changes suggested 10 years ago. They were killed. More changes were suggested and they were killed, and things like that. But now we have something that I think is going to fly. We have a cost principle and I do believe that this time, in the environment that we're in today, there will be a cost principle on corporate aircraft.

Mr. **Wyden**. Nothing substantive has changed in a decade, and I have yet to see anything. Is that correct? Could you give me a yes or no to that one?

Mr. **Starrett**. On corporate aircraft? I think that's correct.

Mr. **Wyden**. Has your policy changed recently with regard to identifying recipients of illegal gratuities?

Mr. **Starrett**. Let me, before I answer yes or no, describe what the policy change was, because the policy change had to do with when we do not know the names of individuals that might have been entertained, we will now refer that for investigation. We would not have done that before. So from that standpoint, I guess the answer is yes, we have changed it.

Mr. **Wyden**. You know it's kind of baffling to me. I mean, I asked you about illegal gratuities. Illegal means illegal. And even though it's illegal you seem to have changed your policy with respect to dealing with these situations.

How much clearer could it be than when you find these instances of illegality they be referred for prosecution?

Mr. **Starrett**. I think it's quite understandable. Again, if you go back to 1978-79 timeframe, the general counsel at the time didn't want anything that was less than $25 to look into. So they said, "DCAA, don't refer to us anything that's less than $25 in the way of a gratuity." So we didn't.

Mr. **Wyden**. Which general counsel was that?

Mr. **Starrett**. Oh, whoever the general counsel was in the last part of——

Mr. **Wyden**. DOD?

Mr. **Starrett**. Yes, Department of Defense General Counsel. So we had a $25 de minimus rule, if you will, so anything less than $25 we did not refer because there are questions that we would not be able to answer. For example, maybe the individual paid the company $25 or whatever.

Mr. **Wyden**. But how did you allow that $1.3 million entertainment account with General Dynamics to go without trying to look behind it?

Mr. **Starrett**. Because they were not claiming those costs against Government contracts. If this is entertainment, $1.3 million, and they are not claiming it, then we don't have any access to the records in that situation.

Mr. **Wyden**. They were claimed. They were in allowable accounts.

Mr. **Starrett**. Well, if it was $1.3 million that we questioned in entertainment——

Mr. **Wyden**. Yes.

Mr. **Starrett**. And the question is then—if we questioned it, then your question is what?

Mr. **Wyden**. Why didn't you go behind them to try to figure out who was actually involved?

Mr. **Starrett**. Because we don't have any responsibility for taking care of or enforcing the standard of conduct rules within the Department of Defense, No. 1.

No. 2, if we say to the company——

Mr. **Wyden**. You are the first line of defense. These are illegal gratuities.

Mr. **Starrett**. I understand that. Could I finish? If you go to the company and you say please provide me a list of all the gratuities and the names of the people that you entertained, we wouldn't get it. We wouldn't get anything.

So what we do is when we are of the opinion that—notwithstanding the fact that we don't know who they are—but when we are of the opinion that they were Government people, we will refer that now for investigation. And the investigators with subpoenas can get that kind of information.

Mr. **Wyden**. You know, we see in report after report that there were Government employees that were being entertained. And I don't see any evidence that you went out and tried to get them. Why not?

Mr. **Starrett**. Well, if those are DCAA reports that say that Government employees have been entertained, then they have been referred for investigation. You see, I'm talking about a situation where we don't know——

Mr. **Wyden**. We are talking about DCAA reports.

Mr. **Starrett**. And it says that they were Government people that were entertained?

Mr. **Wyden**. It's my understanding that those reports were in 1982.

Mr. **Starrett**. But did they say that there were government people entertained?

Mr. **Wyden**. That's our understanding.

Mr. **Starrett**. Then they would have been referred for investigation.

Mr. **Wyden**. Were they referred?

Mr. **Starrett**. I would have to look at the exact reports you're talking about, but that's our policy and was then, even.

Mr. **Wyden**. We're talking about the 1982 overhead reports, so you're saying that you don't know if they were referred?

Mr. **Starrett**. 1982 overhead? For what division of General Dynamics?

Mr. **Wyden**. Headquarters.

Mr. **Starrett**. The corporate office?

Mr. **Wyden**. That's what headquarters means to me.

Mr. **Starrett**. Well, we have 14 cases that we have referred for investigation related to General Dynamics and I will look to see whether or not that's one of them. But if it isn't, then that is not in accordance with our policy.

Mr. **Wyden**. Tell me what the results have been in terms of turning around the situation with the illegal gratuities. What have your new policies produced in this area?

Mr. **Starrett**. We are referring instances where we really do not know who it is that has been entertained, but where we have an indication that it was some kind of Government individual.

Mr. **Wyden**. How frequently do you make these referrals, though? I want to see what results are being produced by this new policy.

Mr. **Starrett**. Well, we have been referring gratuities for a number of years. I don't want you to get the idea that we just started doing that. We have been referring gratuity situations to investigators for as long as I can remember, and we have a number of cases. But we do not get involved with what happens after that because the investigators take over.

Mr. **Wyden**. Has DCAA ever been prohibited from reviewing unallowable entertainment accounts of contractors, in order to identify the recipients of the illegal gratuities?

Mr. **Starrett**. Yes.

Mr. **Wyden**. So DCAA has been prohibited from reviewing the unallowable entertainment accounts, and I would like to know if you think DCAA should be looking at these accounts?

Mr. **Starrett**. We should be looking at these accounts for purposes of making sure that the Government has not paid any costs associated with whatever entertainment that is. And if, during the course of that part of our audit, we find that there were Government people entertained, we would refer it for investigation.

Mr. **Wyden**. So you have access to these accounts today?

Mr. **Starrett**. We have access, yes.

Mr. **Wyden**. Do you think the Department of Defense, the DOD IG, has done an adequate job of looking at these accounts?

Mr. **Starrett**. The inspector general would look at what it is we refer out of those accounts, and I really don't have any feedback at all as to what happens.

Mr. **Wyden**. So you have no contact with the IG on this point?

Mr. **Starrett**. Not on the gratuity type situations. They go interview the individual and they determine whether or not the individual has paid the company for whatever it is that they received, and the disposition of that case does not come back to the Defense Contract Audit Agency.

Mr. **Wyden**. You know, just looking at this in a logical way, shouldn't there be some kind of followup so you and the IG would be communicating with each other with respect to what's happening with these accounts?

Mr. **Starrett**. Well, you know, whether or not a high level individual, after we refer something to the IG—whether or not that individual is found guilty of receiving gratuities and things like that, you know, that would be nice for us to know but it's not really something that we need to know.

What we need to know is whether or not there are people that show up in records that we should refer for investigation, and that's what we do.

Mr. **Wyden**. Why was the DCAA prohibited by General Dynamics for a number of years from interviewing personnel in the G.D. Washington office?

Mr. **Starrett**. They felt that we really had no right to interview the Washington office personnel, and as a result of that we questioned the entire amount, and they didn't even bother to bill it for a number of years. So we weren't paying for any Washington office activities for sometime. Two or three years actually, with General Dynamics.

Mr. **Wyden**. Does DCAA have current access to all the files on the personnel in the General Dynamics Washington office?

Mr. **Starrett**. It's my understanding that we do, yes.

Mr. **Wyden**. Does that mean that you do?

Mr. **Starrett**. To the best of my knowledge we do, yes.

Mr. **Wyden**. When did you last review this situation?

Mr. Starrett. 1982.

Mr. Wyden. So you really wouldn't know, since it has been almost 3 years?

Mr. Starrett. We have not reviewed it in 2 years. Yes; that's correct.

Mr. Wyden. What audits, if any, does DCAA perform on the Washington offices of other contractors?

Mr. Starrett. We perform audits on an assist basis out of the branch offices that are in the Washington, DC, area when the auditor at the location where the company records are kept—for example, General Dynamics it would be St. Louis. When the auditor at the record location feels that it is necessary to do a review of the Washington office, they will request an assist and we will do that out of the local branch offices.

Mr. Wyden. I want to look in detail at this access to records problems and focus initially on the access to records problems at General Dynamics on the $3.8 billion F-16 contract, where the Air Force contracting officer went ahead and negotiated a contract without a completed audit of the General Dynamics pricing proposal on the F-16.

Let's start, if you will, Mr. Starrett, by having you describe title 10 U.S.C. 2276, and particularly, how often is that used by the DCAA in access to records problem disputes at Air Force locations?

Mr. Starrett. That is incorporated, really, in the access clause that is contained in the contract itself, and the contract provides that we will have access to books, records at all reasonable times.

What essentially we do is, if we do not get access, the first thing we do is try to convince the company that they are in violation of the access to records clause that is in the contract. It is there because of that law. And if we can't get any movement at all, we will then start suspending payments, and we will go to the contracting officer and ask the officer to assist us and so on.

Mr. Wyden. But tell me about particularly the F-16 contract and the problems associated with that.

Mr. Starrett. In that particular procurement, I recognized the dollar figure, $3.8 billion, I think it is. The Air Force was for some reason or other—I don't know exactly why—very anxious to get that contract let. They wanted another proposal at the same time we were reviewing the original proposal to the Air Force. We were trying to get the information from the company and they had been asked by the Air Force to provide another proposal which required getting all kinds of other information.

As a result, it was very difficult for us to get very much from the company in support of the original proposal because they were busy changing it, and we had a very short deadline. We ended up issuing a report saying to the Air Force that we do not feel that we can give you anything that you should use as a basis for negotiation of a price.

Mr. Wyden. So the Air Force went ahead with this contract, a $3.8-billion contract, anyway?

Mr. Starrett. It is my understanding that later on the Air Force then came back and asked us to do a review, and we did a review. We got the cost and pricing data we wanted and we gave them a report that was not qualified. Actually, the first report was not only qualified; it said you should not negotiate a price on the basis of this.

Mr. **Wyden**. I guess the taxpayers would want to know: did you get the money back?

Mr. **Starrett**. Well, at that time we were negotiating a price for something in the future. We hadn't settled on a price at that point.

Mr. **Wyden**. Why would you go without a completed audit, though, for a contract of $3.8 billion?

Mr. **Starrett**. Yes. Well, my information indicates that they did not. We issued a report, that's true, that said we do not recommend that you negotiate a price on the basis of this review, but they then came back later on and said please make a review. We had the time and we did a review, and then negotiated the price.

But there is in the record a report from DCAA that says that we don't recommend that the price be negotiated on the basis of this audit.

Mr. **Wyden**. I am not completely familiar with this issue, Mr. Starrett, and I want you to tell me your analysis of it. We have been looking at General Dynamics and Pratt & Whitney, but I have heard some discussion that DCAA has had access to records problems at Westinghouse in Baltimore—is that right?

Mr. **Starrett**. There is no question about that. We are in court right now with Westinghouse.

Mr. **Wyden**. Over what documents?

Mr. **Starrett**. Internal audit reports.

Mr. **Wyden**. What do these documents show?

Mr. **Starrett**. We haven't seen them. That's what I would like to know.

Mr. **Wyden**. What are the allegations of what the documents would show, if you have the documents?

Mr. **Starrett**. It could be anything. Our point is that as far as we are concerned, we are entitled to access to internal audit reports. They are internal controls within the company. We are responsible for evaluating internal controls within the company. We pay for the internal audit organization, and we think that we should have access to those, and we get access at the majority of defense contractors.

Mr. **Wyden**. Isn't it correct that what these documents deal with is an allegation that there was an embezzlement scheme or arrangement?

Mr. **Starrett**. One of the allegations is that there was some activity related to using moneys for office parties or something to that effect. I can't remember exactly what it is. But there is some concern in that area.

Mr. **Wyden**. Where is it alleged the money was coming from?

Mr. **Starrett**. I don't really know. Westinghouse—you know they have a fairly substantial percentage of commercial work besides the Government work. What we want the internal audit reports for is to find out the answers to these questions. We want to know whether or not Government contracts were charged with any of that, and if the internal auditors looked at it, we feel we are entitled to it.

I will be testifying next Wednesday in Pittsburgh on that subject, and hopefully I will be able to convince the judge that we should have access to internal audit reports.

Mr. **Wyden**. Again, this is pretty new material to me, but it seems to me that the Government paid for the audits, and maybe you could enlighten the subcommittee as to why Westinghouse would refuse to provide them.

Mr. **Starrett**. It is a mystery to me, too. I don't understand it.

Mr. **Wyden**. Would you think that this is behavior reflective of somebody trying to hide something?

Mr. **Starrett**. I think that is exactly why we want to see them. You know, as an auditor, that really piques our interest. When somebody says you can't see this, that or the other thing, that just makes us want to see it all the more.

Mr. **Wyden**. Mr. Starrett, I didn't know much about this issue until a few minutes ago, and I must say my interest is piqued, as well.

I want to yield to the gentleman from Florida for any questions he may have, and hopefully we will have some more time.

Mr. **Bilirakis**. Are you trying to tell me something, Mr. Chairman?

Mr. **Wyden**. No. It is the gentleman's time.

Mr. **Bilirakis**. Thank you.

Mr. Starrett, you know, when the hearings took place a few weeks ago regarding General Dynamics, the reaction that I had to it all was where are the auditors? Where have the auditors been? Claims are filed right there at the particular location. Are they doing their job? And if they are doing their job, then there isn't any reason why these things should be picked up somewhere downstream. They should be stopped right at that particular point in time.

I would ask you that question now as the Director of the DCAA. Are they doing their job? If they are not doing it adequately, what is necessary in order to help you get the job done adequately? You know, we are still spending taxpayers' dollars.

Mr. **Starrett**. All right. Succinctly, where were the auditors? As far as executive aircraft costs are concerned, the source of all the information related to that subject is the Defense Contract Audit Agency and our audit reports. As far as where we are on our audits of General Dynamics, we do not have a 1984 claim yet so we do not know what it is that General Dynamics might claim related to some of the expenses that have been discussed in this hearing that were incurred in 1984.

We don't know whether they will claim them or not, but if they claim them, I can assure you, sir, that they will not be allowed. We will properly take care of that in the Defense Contract Audit Agency.

In 1983 we have not completed our audit, so therefore our audit report has not been issued, and we will cover anything and everything that has come up in these hearings related to dog kennels and so forth if we did not already know it, and I'm not sure that we didn't already know about those things. But when we issue the audit report, they will be in there.

Mr. **Bilirakis**. All right That is the audit report on an after-the-fact basis. I am referring to the claims that are submitted to the local auditor at the time that the claims are made. What happens at that point?

Mr. **Starrett**. The process provides that there is a billing rate established before the year begins, and that billing rate is set lower than what the company actually expects to be the overhead rate. The reason it is set lower is because we don't want to pay for dog kennels or expressly unallowable costs in any way, shape, or form, not even for a while.

So, by establishing that rate at the beginning of the year and paying the company less than they incur all year long, we don't end up paying the total amount that the company might feel they are entitled to. We will be withholding money.

And specifically in the General Dynamics case, that process resulted, as shown by our review last month, in our holding $90 million. We have been holding $90 million of General Dynamics' money for a long time, we had never paid them the $90 million that we were withholding.

We concluded, however, that we have got a number of technical issues with General Dynamics related to things like the settlement of insurance which is one, for example, that we think doesn't need to go to court. Somebody needs to sit down and settle it.

As far as workmen's compensation is concerned, we have over $40 million questioned related to workmen's compensation, and those things added up to about $154 million. We think we ought to hold that money to get everybody to the table so that these things can be settled.

Mr. **Bilirakis**. Well, Mr. Starrett, I may be showing my ignorance here, but you have established these rates. Is there a basis for establishing these rates?

Mr. **Starrett**. Yes, sir. It is included in the Federal Acquisition Regulation, and the process is explained there that the billing rate will be established and it will be established based on what is anticipated to be the allowable cost, what the company expects to incur, which would be evaluated to see whether or not we would agree with that, less an amount——

Mr. **Bilirakis**. But no specifics at that point in time, right?

Mr. **Starrett**. Well, the costs have not been incurred yet so we are setting a billing rate before they have been incurred.

Mr. **Bilirakis**. All right.

How often do they bill, then, for recovery of those costs?

Mr. **Starrett**. That billing rate is used in each billing that is submitted as work progresses, and it is adjusted during the year depending on what the history shows of the company experience in the overhead area.

Mr. **Bilirakis**. All right.

When do you first run into these expenses that you have already told us are unallowable, such as advertising, bad debts, dog kennels, et cetera, some of the things we heard yesterday? When do you first become aware that those are a part of what they are claiming or that they may be claiming as overhead costs?

Mr. **Starrett**. The company is supposed to submit a claim for overhead for a particular year, within 90 days after the close of the fiscal year.

Mr. **Bilirakis**. And that is for the past full year?

Mr. **Starrett**. That's correct. They frequently don't make the 90 days, but nevertheless, that is when the claim comes in and that is when we know whether or not certain of these expenses that are on their books they are going to actually claim.

Mr. **Bilirakis**. So an entire year has gone by. What do the auditors do during that entire year's period of time since the specifics of their overhead claims do not come forward until a year has gone by, 30 days afterward? What happens within that year's time?

Mr. **Starrett**. Yes, I understand the question. What we are doing at any particular location is we will be doing floor checks to make sure the company is charging the work to the right contracts. We will be reviewing significant cost areas that we know they are going to claim—for example, workmen's compensation, insurance programs, things like that. I mean there is just more work than you can imagine in a large company to go all year long.

But then when we get this claim that is after the end of the year, that is when you have accounts in it that may have the dog kennels and things like that. We need that information before we go back and spend time going through accounts where the company may not even claim it anyway. There is no sense in spending audit time all year long looking at an account that the company is not going to claim.

Mr. **Bilirakis**. Right. You are not going to check on a dog kennel until you think they might claim it.

Mr. **Starrett**. That's right. If they claim it, then we will throw it out.

Mr. **Bilirakis**. What guidelines are available for your auditors to determine whether or not these claims are legitimate ones?

Mr. **Starrett**. It is the cost principles that are included in the Federal Acquisition Regulations.

Mr. **Bilirakis**. Are they definitive enough?

Mr. **Starrett**. In some cases, no. We have been making recommendations for closing some of the loopholes in those cost principles for some time, and the answer to your question is there are problems with them. I don't think you will ever be able to write a set of cost principles that will cover every specific thing that might happen out there, but I think we can do a little better.

Mr. **Bilirakis**. Well, you concur then with Mr. Spanton's comments that a different auditor may apply a different philosophy to the same claim and come up with a different result?

Mr. **Starrett**. I wouldn't agree with that; no.

Mr. **Bilirakis**. You would not?

Mr. **Starrett**. No. As a matter of fact, I find a number of things that Mr. Spanton said that I don't agree with; however, I think we're both going in the same direction; we would like to make the system better if we possibly could. I say that because we're very busy in the Defense Contract Audit Agency putting out guidelines that are included in the Contract Audit Manual whereby we assure, just as much as we possibly can, that there is consistency among DCAA auditors.

Mr. **Bilirakis**. Even though a year has gone by, if your auditors decide to disallow a claim, what is the scenario after that?

Mr. **Starrett**. If it is an overhead that's going to be negotiated by the contracting officer, we will write an audit report and include all the information in that audit report related to the unallowable costs, and it will then go to negotiation. The company will be provided an opportunity to comment on our audit report, the contracting officer will then look at our audit report and the contractor's rebuttal, and then have a negotiation and try to resolve the issues that are involved.

Mr. **Bilirakis**. And what part does DCAA play in all that?

Mr. **Starrett**. We assist the contracting officer in negotiations and we will respond to the contractor's rebuttal for the contracting officer, and it is a process that includes us supporting the contracting officer.

Mr. **Bilirakis**. I will yield to the Chairman.

Mr. **Wyden**. I want to let the gentleman from Florida finish his questions. I was just hoping to ask one or two more as well, within our tight time line. But it's the gentleman's time, from Florida.

Mr. **Bilirakis**. Well, I am just not satisfied, and it's not a matter of not believing Mr. Starrett--but it does appear that DCAA auditors do not have adequate guidelines which are consistent and stable enough to determine the type of expenses that are allowable overhead expenses.

Well, Mr. Chairman, I will yield the balance of my time to you. I would just merely say that in the process of our trying to understand this subject and hopefully doing our part in trying to clear it up, I think it might be wise to take a trip to some of these locations, defense contract locations, and actually visit the DCAA and follow it step by step as to what they do with some of the claims that come in and how they handle those claims.

It might help us. I'm sure members of the staff have done this, but I don't think too many of us have. I know I haven't for a long time.

Thank you, Mr. Chairman.

Mr. **Wyden**. That might well be an advisable idea and I thank the gentleman.

Just another couple questions, Mr. Starrett. I've got here your DCAA report of 1982, on General Dynamics overhead. And it says, and I want to quote, "The contractor entertained several key military personnel."

Now my question to you: Was this referred to the IG? I can give you a little bit more on it but the key sentence is at page 52: "We have identified several specific instances in which the contractor entertained key military personnel." And what the subcommittee is most interested in is whether this was referred to the IG.

Mr. **Starrett**. Could you give me the date of that report?

Mr. **Wyden**. August 28, 1984. We're talking about calendar year 1982.

Mr. **Starrett**. OK. But the date of the report would be—I don't see it.

Mr. **Wyden**. Excuse me. The DCAA Audit Report is dated July 23, 1984.

Mr. **Starrett**. I don't have that one on my list.

Mr. **Wyden**. So it was not referred?

Mr. **Starrett**. It does not look that way.

Mr. **Wyden**. Why not?

Mr. **Starrett**. It should have been.

Mr. **Wyden**. What are we going to do now?

Mr. **Starrett**. We will refer it.

Mr. **Wyden**. Right away.

Mr. **Starrett**. Yes, sir.

Mr. **Wyden**. OK.

One other question. The 1977 DCAA Audit of General Dynamics Corporate Overhead did not audit General Dynamics' $2 million travel account because General Dynamics erased the master file general ledger tape and advised the DCAA that the cost to reconstruct the master file tape would be prohibitive.

Now, the DCAA resolved the matter by basing their audit results on their previous year's audits under apparently very little, if any, protest from General Dynamics.

Now, I'd like to ask you, Mr. Starrett, whether you believe that General Dynamics actually erased this tape?

Mr. **Starrett**. My understanding is that they destroyed the tape, and I don't know that there was any intent to keep it from us, really, in destroying it. I think it was a mistake that it got destroyed.

However, the important thing is that the supporting documentation was not. So that we have all of the individual records. They are still there; it's just much more difficult for us to analyze each and every one of those records without having this tape. It's an intermediate record that makes it much—that facilitates our audit, in effect.

Mr. **Wyden**. Don't people usually have some kind of backup tape?

Mr. **Starrett**. I should hope so. Yes. That would be a good idea.

Mr. **Wyden**. Why do you think there wasn't one in this case?

Mr. **Starrett**. I don't know. But the prior year it was there. The year after that it was. I think this was just a mistake. I just think they goofed and destroyed it unintentionally. Like I say, if they had something they were going to hide, it would seem to me that the supporting documentation would be also missing, and it was not.

Mr. **Wyden**. Oh, I don't know if I'd go along with that. You yourself just told us that if you don't have the tape and you don't have the master, it's pretty cumbersome.

Mr. **Starrett**. Yes, it is.

Mr. **Wyden**. And I guess my question to you is: Do you think that the tape was deliberately destroyed, given the fact that the subcommittee staff has determined that this same account was used to entertain governmental officials? Do you think that this was just an accident, or do you think it was deliberately destroyed?

Mr. **Starrett**. I would have to rely on the auditors that were there, and their information and their view is that it was not—that it was just an accident.

Mr. **Wyden**. Did the erased tape stop the normal DCAA audit?

Mr. **Starrett**. It required that we do a lot more work because we would not have the tape to run what we call a COSAM program.

That's a program that would automatically kick out, on a statistical basis, individual transactions for us to review. So it certainly made it more difficult.

Mr. **Wyden**. We have a copy of that audit, the 1977 audit, and as far as I can tell, it was stopped. We see in the audit, it is stated, "After discussion with Mr. Paul J. Webb, CACO, it was agreed that total travel expense question would be based on the CY76 results of the audit." That looks to me like stopping the audit.

Mr. **Starrett**. Well that is—Paul Webb was the contracting officer that worked for the Navy at the time, and that was a long time ago.

Mr. **Wyden**. He was right before Modisett.

Mr. **Starrett**. I believe he was.

Mr. **Wyden**. It looks to me like the audit was stopped, and I'd like to hear any evidence you may have that would indicate otherwise.

Mr. **Starrett**. Well, I really didn't say anything that contradicts that. I'm really not sure. I think that what they did, rather than go through all these individual documents I think they did use the last year's history and project it that way.

Mr. **Wyden**. Can a CACO stop an audit?

Mr. **Starrett**. No.

Mr. **Wyden**. The gentleman from Florida has one additional question and then we have some formalities to take care of. The gentleman from Florida?

Mr. **Bilirakis**. Thank you. In a fixed-price contract, Mr. Starrett, are the overhead costs set aside as separate allocations from the actual negotiated fixed price?

Mr. **Starrett**. In the negotiation of a firm, fixed-price contract you come to the table and negotiate overhead rates and everything else—material costs—in the same way as you would in a flexibly priced type contract.

By that I mean in a firm, fixed-price negotiation you're going to agree we will pay this amount of money when you deliver whatever it is.

Mr. **Bilirakis**. And that amount of money includes all the overhead costs?

Mr. **Starrett**. That's correct, in accordance with the negotiated amount, yes.

Mr. **Bilirakis**. In accordance with the negotiated total dollar amount; is that right?

Mr. **Starrett**. Yes. You sit down and negotiate that price, and that price will include overhead.

Mr. **Bilirakis**. Right. OK.

Therefore, is it necessary for your people to audit the overhead costs in those types of contracts? And if it is, why would you do so?

Mr. **Starrett**. It is necessary for us to review that firm fixed-price proposal if it is going to be negotiated, and it would be necessary for us to look at all the supporting documentation and evaluate the projection of overhead that's included in that proposal, in that pricing proposal. And then at the time that we finally go to the table and negotiate, you know, $1 million for these widgets, whatever they are, then the Government is agreeing at that time to pay $1 million per widget, and there would be no need to audit those costs.

Mr. Bilirakis. There would be no need to audit those costs. So if they decide they want to pay for a dog kennel or whatever the case may be, it comes out of their potential profit.

Mr. Starrett. We would pay $1 million for these widgets because that's what we negotiated.

Mr. Bilirakis. Well, what percentage of Government contracts do we have that are fixed price? Firm fixed-price contracts?

Mr. Starrett. Oh, it depends on the location. There are some companies that have nothing but firm fixed-price contracts, and there are others that have hardly any at all. General Dynamics has very few, for example.

Mr. Bilirakis. Well, tell me, why would the Government not enter in every case into a firm fixed-price contract?

Mr. Starrett. Because at the time that you sit down at the table to negotiate, you may not know exactly what it is you are buying. It could very well be something that is pushing——

Mr. Bilirakis. Well, I can see that in research and development contracts and experimental, that sort of thing. Sure. But is that what we have here? Certainly that wasn't the case, I don't think, with the General Dynamics contracts that are being questioned now. And it wasn't the case in Pratt & Whitney, was it?

Mr. Starrett. I'm a great advocate of firm, fixed-price contracts, and anytime we can negotiate a firm fixed-price contract, I think we should. But there are sometimes too many risks that nobody knows that much about, so therefore, you negotiate a fixed-price incentive contract where there is a ceiling, and the Government says, we will not pay you any more than this ceiling, but here is a target price that we are hoping for.

Mr. Bilirakis. And then you have an incentive.

If it's a firm fixed-price contract and the contract is overrun, we ordinarily would not pay that overrun, would we?

Mr. Starrett. On a firm fixed-price contract we would not. We would simply pay the $1 million that we agreed to, every time you deliver one of these.

Mr. Bilirakis. The firm fixed-price contracts in most cases then would appear to be much of the answer to our problem.

Mr. Starrett. I believe if we could negotiate firm fixed-price contracts, it certainly would help, and it would save us a lot of audit effort as well.

Mr. Bilirakis. Amen to that.

Thank you, Mr. Chairman.

Mr. Wyden. Thank you. One last question, then a couple procedural matters.

Mr. Starrett, do you think we ought to consider reopening that 1977 audit?

Mr. Starrett. The 1977 audit?

Mr. Wyden. The 1977 audit where the tape was destroyed, where we are looking at General Dynamics corporate overhead.

Mr. Starrett. Oh, we would be glad to.

Mr. Wyden. The subcommittee would like you to reopen the audit.

Mr. Starrett. Yes, sir.

Mr. **Wyden**. And report the results to us as well.

Mr. **Starrett**. OK.

Mr. **Wyden**. When might we expect such a report?

Mr. **Starrett**. Well, now that you are the contracting officer, it will be about 30 days, sir.

Mr. **Wyden**. It's a new hat.

OK. A couple other things, Mr. Starrett. First, the subcommittee wants to express its appreciation to you for cooperating with the subcommittee. You have been very patient. We've been at it for 2 long days; it is late in the day and I have been advised by the Chairman that we would like to look at the possibility of bringing you back another time. Would you have any objection to that?

Mr. **Starrett**. I think that we will consider your invitation at the time. No question, we will consider your invitation.

Mr. **Wyden**. And also, on another occasion we may want to discuss matters relating to Mr. Spanton. I think you're aware that I asked some questions about that yesterday, and we may want to consider that with you at another time as well.

Mr. **Starrett**. All right.

Mr. **Wyden**. Unless you have any further comment, you are excused as a witness.

With that, the Subcommittee on Oversight and Investigations is adjourned.

[Whereupon, at 5:07 p.m., the Subcommittee was adjourned, to reconvene at the call of the Chair.]

[The following material was received for the record:]

DEFENSE CONTRACT AUDIT AGENCY
CAMERON STATION
ALEXANDRIA, VIRGINIA 22314

OFFICE OF THE DIRECTOR

28 MAY 1985

Honorable John D. Dingell
Chairman, Subcommittee
on Oversight and Investigations
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

Attached is the corrected copy of my testimony given before your subcommittee on 24 April 1985. Also attached is my Statement to be inserted at line 5797 of page 238.

During my testimony I was asked about the change in the disallowance factor for calculating General Dynamics billing rates. I have researched that with my field office at St. Louis and determined that in October 1984 the Corporate Administrative Contracting Officer (CACO) established a factor of 9.7 percent withholding for all corporate level expenses allocated to the various divisions of General Dynamics. Prior to that time each local ACO was on their own to withhold a level of expense that would include both local and anticipated corporate unallowable expenses. This 9.7 percent withhold factor applied to all costs billed subsequent to 1978.

In December 1984, the CACO issued another letter which reflected a 14.1 percent withhold factor for billings of 1983 costs only. This special 1983 rate reflects the withholding of costs related to AT&T litigation that were booked during 1983. Neither of these two rates included a withholding for corporate aircraft expense.

In April of 1985, a revised schedule of allowable dollars of corporate expense for each year, 1978 through 1985, was issued by the CACO. This schedule, which was based on the types of costs questioned in the DCAA audit report covering 1982, reflects an average withholding of 38 percent, made up of the 9.7 percent plus 10 percent for corporate aircraft, and 18.8 percent for foreign marketing expenses. I am unable to identify the 30 percent mentioned by Mr. Wyden during my testimony.

I was also asked about the most recent review of General Dynamics executive compensation expenses. As I stated during the testimony, the Defense Logistics Agency has been assigned the DoD responsibility to perform executive compensation reviews. My auditors review executive compensation as well as insurance and pension costs as a part of an overall audit of forward pricing agreements, but DLA is responsible for specialized reviews. The most recently completed executive compensation review is dated 28 May 1982 and was issued by Defense Contract Services Region—St. Louis, to Headquarters Naval Material Command Bldg 5, Crystal City, VA.

As we discussed with Pete Stockton, DLA Office of Congressional Affairs has informed us that a request would have to be directed to the Navy for release of this report.

At the close of the testimony, Mr. Wyden asked that we reaudit the 1977 General Dynamics corporate travel expense account and report the results to the committee. As Pete Stockton agreed in a subsequent conversation, we are not in a position to reopen the negotiation. It would not be beneficial to do any additional audit work until such time negotiations are reopened, therefore, the request to reaudit the 1977 travel expenses has been put on hold.

Sincerely,

C. O. STARRETT, JR.
Director

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U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

ROOM 2317
RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-4441

June 26, 1985

The Honorable Caspar W. Weinberger
Secretary of Defense
Department of Defense
The Pentagon
Washington, D. C. 20301

Dear Mr. Secretary:

As a follow-on to the appearance of the former Director of the Defense Contract Audit Agency (DCAA), Charles O. Starrett, Jr., before the Subcommittee on Oversight and Investigations on April 24, 1985, it is requested that the Subcommittee be furnished with answers to the enclosed questions by close of business, Monday, July 8, 1985.

The continued cooperation of the DCAA with the Subcommittee is appreciated. Peter Stockton or Jeffrey Hodges of the Subcommittee staff are available to answer any questions that might arise. They can be reached on 225-4441.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

Enclosure

BEST COPY AVAILABLE

1. Please provide the following information on General Dynamics corporate overhead rates by year from 1976 to the present:

    a. General Dynamics proposed corporate overhead billing rate;

    b. DCAA recommended billing rate;

    c. negotiated billing rate approved by the Administrative Contracting Officer; and

    d. the final audited rate.

2. The Subcommittee understands that the DCAA has a substantial workforce located across the country. Do you agree that the DCAA is wasting its time in ferreting out unallowable/ fraudulent charges when the contractors should not be submitting these types of vouchers in the first place?

3. General Dynamics and other defense contractors have been playing the game of "catch me if you can" with the DCAA for many years. Are they playing this game because there are no penalties for getting caught? How can contractors possibly lose in this game? What actions has the DCAA taken, and at what levels within the DOD, to bring this practice to a halt?

4. The Department of Justice recently indicted the General Electric Corporation for mischarging direct labor costs to government contracts. How many DCAA audits during the past five years have disclosed mischarging, intentional or otherwise? With respect to mischarging of labor costs to government contracts, please provide all such audit reports pertaining to major contractors, and all substantive audit reports with respect to other contractors for the last five years.

5. Does the DCAA maintain statistics to show the individual categories of overhead costs, i.e., travel, entertainment, public relations, advertising by major defense contracts -- how much was audited and how much was questioned? Please indicate the extent and scope of the statistical sampling used in the amounts considered audited.

6. The Subcommittee understands that engineering costs charged directly to government contracts by defense contractors often constitute a material portion of total costs. How, and to what extent, does DCAA audit, verify and validate this particular element of cost? Specifically, reference is made to the number of engineering hours charged against the contract.

7. Mr. Starrett testified that the DCAA has referred fourteen cases to the Inspector General (IG) for investigation regarding General Dynamics. Please provide a list of the fourteen cases and information regarding each case.

8. The Washington Post reported on Sunday, April 21, 1985, about the results of an IG report that found that contracting officers were negotiating contracts without the required DCAA audit of the proposed pricing. It appears that there are billions of dollars of contracts slipping through with no government audits -- with the government essentially allowing the contractor to determine the fair and reasonable price. List all instances of procurements without audits in the past five years.

   a. Why does this happen?

   b. Has the DCAA complained about this practice? If so, to whom?

9. Are contracting officers failing to get DCAA audits of updated data provided by the contractors during negotiations? Please explain the scope and frequency of this problem.

10. What was the DCAA's role in reviewing the $544 million General Dynamics claim filed in December 1976 on the SSN 688 Class nuclear attack submarine program?

   a. If the DCAA had no role, please explain.

   b. Did the DCAA offer any protest? If so, to whom? Please supply documentation.

   c. Why did the Secretary of the Navy keep these claims away from the DCAA?

11. In 1979, the DCAA wrote a letter to General Dynamics requesting that General Dynamics retain the passenger lists of their corporate aircraft. Notwithstanding this letter, General Dynamics continued to destroy the passenger lists.

    a. Who did the DCAA complain to at the Pentagon about this problem?

    b. Why did the DCAA not exercise its authority to stop payment on this account? Please explain.

    c. General Dynamics has received over $10 million in progress payments for their corporate aircraft between 1978 and 1983 -- despite the continued destruction of the passenger lists. Why did the DCAA put up with this?

    d. Did the DCAA know that David Lewis, the Chairman of the Board of General Dynamics, was making personal flights on corporate aircraft and charging the taxpayers about a million dollars for these personal flights? Please supply documentation.

    e. Did the DCAA refer these apparently fraudulent charges to the proper authorities? Please explain thoroughly.

    f. Are the General Dynamics claims for Mr. Lewis' personal flights considered an "expressly unallowable" cost? Please explain.

12. We understand that General Dynamics is appealing the corporate aircraft issue to the Armed Services Board of Contract Appeals (ASBCA). Why should this even be an appealable issue when they destroyed the passenger lists?

13. What action did the DCAA take on the last Navy contracting officer's decision in 1981 to give General Dynamics 75 cents on the dollar for the use of corporate aircraft in 1977 despite the destroyed passenger lists? If the DCAA did not take any action on the reinstatement of the 75 cents on the dollar for the aircraft costs, please explain.

14. Mr. Starrett testified that "as far as executive aircraft costs are concerned, the source of all the information related to that subject is the Defense Contract Audit Agency and our audit reports." Is the DCAA claiming that the DCAA was aware that the personal flights made by D. S. Lewis were charged to the government? Does the DCAA think these claims were fraudulent? Why did the DCAA not turn the matter over to the DOD Inspector General?

15. The Subcommittee understands that the DCAA has made attempts to obtain changes in the Defense Acquisition Regulation (DAR) regarding payment for corporate aircraft charges. How long has this lack of meaningful action been going on? Has the DCAA been sufficiently forceful in this matter?

16. It is noted that DCAA audit report, number 3201-4A140001, dated July 23, 1984, of the General Dynamics Corporation's corporate office expense allocations, contains the following notation: "We have identified several specific instances in which the contractor entertained key military personnel."

    a. Did the DCAA refer this apparent violation of Federal law and DOD regulations to the DOD Inspector General or other investigative authority? Explain fully.

    b. Did the DCAA advise the cognizant DOD component of this possible violation of the contract(s) with the Government? Explain fully.

    c. Has the DCAA changed its procedures regarding the reporting of gratuities? Please furnish any applicable documentation. Do you consider it acceptable policy for DCAA to recommend any monetary amount as permissible for DOD officials to be entertained? Why was this done?

17. In response to the question of when was the last time the DCAA audited executive salaries at General Dynamics, Mr. Starrett responded by stating that "the Defense Logistics Agency (DLA) was delegated the authority and the responsibility for reviewing compensation at major defense contractors about a year and a half ago".

    a. When was the last time that the DCAA audited executive salaries at General Dynamics?

b. Is the DCAA saying that the DLA has taken over DCAA's responsibility for cost determinations of the reasonableness of executive salaries? What about with respect to all other compensation cost audits?

c. What audits of executive compensation did the DCAA perform prior to the transfer of this function to the DLA? Please furnish copies of all such audits conducted during the past five years.

d. Who directed the DLA to assume DCAA's function and under what authority?

18. Mr. Starrett testified that defense contractors have expressly unallowable costs on their books quite often. Why is the DCAA permitting contractors to put expressly unallowable costs in allowable accounts?

19. Mr. Starrett testified that last year the DCAA had a 74 percent of cost question sustained rate in the incurred cost area. Mr. Starrett said this would include overhead. Is it not possible that the high percentage of cost question sustained rate is being affected by auditors who are reluctant to question difficult cost areas where they will not be supported?

20. The DCAA's access-to-records problems have been cited by the General Accounting Office and the DOD Inspector General. Why do these problems exist? How extensive are they? What has the DCAA done about correcting this situation? What is the current status? Under what circumstances will the DCAA agree to refrain from examining contractor records? Explain fully.

Mr. Starrett stated that all major DCAA offices have access to contractor unallowable accounts, including those considered proprietary and unclaimed. Do you agree with Mr. Starrett that the DCAA has access to contractor unallowable accounts?

21. How many Form 1's, "Cost Questioned Disallowance" have been issued during the past five years by the DCAA? Please furnish copies of these Form 1's.

THE SECRETARY OF DEFENSE
WASHINGTON THE DISTRICT OF COLUMBIA

19 SEP 1985

RECEIVED
SEP 20 1985
Subcommittee on Oversight
and Investigations

Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy & Commerce
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

Your letter of June 26, 1985 forwarded follow-on questions related to the appearance of the Director of the Defense Contract Audit Agency before your subcommittee on April 24, 1985.

Enclosed are my responses to those questions. Please note that we have eliminated certain information from the audit reports in Appendix E of the response because we are not at liberty to disclose sensitive, proprietary data collected in confidence from the contractors concerned. Do not hesitate to contact me if you believe that additional information about the Defense Contract Audit Agency is relevant to your investigation of the activities of certain Defense contractors relating to Federal securities laws.

Sincerely,

Enclosures

(Note: Certain enclosures referred to may be found in subcommittee files.)

1. Question. Please provide the following information on General Dynamics corporate overhead rates by year from 1976 to the present:

   a. General Dynamics proposed corporate overhead billing rate;

   b. DCAA recommended billing rate;

   c. negotiated billing rate approved by the Administrative Contracting Officer; and

   d. the final audited rate.

   Response. General Dynamics (GD) Corporate Office does not propose a corporate billing rate. For estimating and interim billing purposes GD submits an annual forecast of corporate office general and administrative (G&A) expenses for future years. The forecast sets forth total corporate office G&A expenses and the allocation of these expenses to divisions such as Convair, Electric Boat etc. The DCAA corporate office auditor reviewed each forecasted corporate G&A expense proposal and issued an audit report to the Corporate Administrative Contracting Officer (CACO) with recommendations regarding the reasonableness of the forecasted expenses. Copies of the audit reports were concurrently provided to the DCAA Resident Auditors at the various GD divisions who incorporated the recommendations made by the DCAA corporate office auditor in the divisional overhead and G&A reports.

   Beginning in October 1984 the CACO asserted his administrative authority and instructed the DACOs to withhold 9.7 percent of the corporate office G&A expenses allocated to the various GD divisions. This withholding is applicable to the year 1978 through 1984 (except 1983 for which the rate is 14.4 percent because of unallowable extraordinary litigation expenses in conjunction with a legal suit against AT&T) as well as the current year forecasted corporate G&A expenses. It is noted that the 9.7 percent withholding substantially supports the DCAA recommendations pertaining to actual corporate G&A expense claims. In addition, DCAA questioned corporate aircraft expenses which have also been disapproved and are under litigation.

   The GD Corporate Office submits an annual corporate office G&A expense settlement proposal (after the fact submission) to determine expenses to be allocated to GD segments. The contractor's proposed and DCAA recommended expenses for each year beginning in 1976 are shown below. We have not completed our review of the 1983 settlement proposal.

CONTINUATION OF RESPONSE TO QUESTION 1

Year	Booked	Deleted	Claimed	Questioned	Negotiated
1976	N/A	N/A	$20.1	$3.1	$18.8
1977	$24.6	$.7	23.9	4.7	22.5
1978	31.0	1.0	30.0	5.5	a, b
1979	37.0	1.0	36.0	16.2	a, b
1980	44.4	2.3	42.1	15.0	a, b
1981	43.9	1.9	42.0	13.6	a, b
1982	51.6	1.9	49.7	18.9	a, b
1983	61.2	3.8	57.4	c	a, b

N/A - Not available.
a - Not negotiated.
b - Estimated unallowable costs were withheld from current billings to protect the interests of the Government and the taxpayers.
c - Not audited.

($ in millions)

2. Question. The Subcommittee understands that the DCAA has a substantial workforce located across the country. Do you agree that the DCAA is wasting its time in ferreting out unallowable/fraudulent charges when the contractors should not be submitting these types of vouchers in the first place?

Response. There is no question that audit time could be saved if all Defense contractors would voluntarily eliminate all unallowable costs from their cost submissions. This does not mean that DCAA could completely eliminate all audit reviews however, because some review is needed to assure contractor compliance with its established procedures. Honest differences of interpretation of applicable contract provisions will result in the auditors questioning some costs even if the contractor has a policy of eliminating all costs which it interprets as unallowable.

3. Question. General Dynamics and other defense contractors have been playing the game of "catch me if you can" with the DCAA for many years. Are they playing this game because there are no penalties for getting caught? How can contractors possibly lose in this game? What actions has the DCAA taken, and at what levels within the DOD, to bring this practice to a halt?

Response. The use of penalties to discourage submissions of cost claims that include unallowable costs is a viable method of minimizing the "catch me if you can" attitude. As you are aware both the House and Senate have recently posed amendments to the authorization bills which would initiate such penalties. Both the Deputy Secretary of Defense and the Director of DCAA have testified in favor of the use of penalties.

4. Question. The Department of Justice recently indicted the General Electric Corporation for mischarging direct labor costs to government contracts. How many DCAA audits during the past five years have disclosed mischarging, intentional or otherwise, with respect to mischarging of labor costs to government contracts. Please provide all such audit reports pertaining to major contractors, and all substantive audit reports with respect to other contractors for the last five years.

Response. Last year DCAA issued about 60,000 reports. Individual findings contained in each audit report are not categorized or tracked. Therefore, we have no means of identifying the number of audits that have disclosed instances of mischarging. As discussed with Jeff Hodges of your staff, we have enclosed recent examples of audit reports which include mischarging findings (see Tab A).

When situations are identified where intentional mischarging may have occurred, DCAA reports them to the appropriate investigative agency. To provide some insight on the extent of such activity, during Fiscal Year 1984, DCAA referred 29 cases of labor mischarging for investigation.

5. Question: Does the DCAA maintain statistics to show the individual categories of overhead costs, i.e., travel, entertainment, public relations, advertising by major defense contracts -- how much was audited and how much was questioned? Please indicate the extent and scope of the statistical sampling used in the amounts considered audited.

Response: DCAA does not record audit statistics by individual categories of overhead costs. Statistics are maintained by type of audit assignments initiated.

Presented below are the incurred cost dollars audited, cost questioned, and sustained for the last five years. The extent to which statistical sampling is applied in the audit of incurred costs depends on the nature and type of cost being audited. Certain types of expense may be audited 100 percent while other types of expenses may be sample tested on a limited basis.

Fiscal Year	Amount Audited	Amount Questioned	Amount Sustained	Percentage Sustained
1980	$11,418.0	$ 716.1	$453.6	63.3
1981	14,562.7	1159.7	751.0	64.8
1982	13,736.3	958.8	650.7	67.9
1983	12,423.1	869.4	634.6	73.0
1984	11,774.6	874.3	648.0	74.1

($ in millions)

6. Question: The Subcommittee understands that engineering costs charged directly to Government contracts by defense contractors often constitute a material portion of total costs. How, and to what extent, does DCAA audit, verify, and validate this particular element of cost? Specifically, reference is made to the number of engineering hours charged against the contract.

Response: DCAA is involved with labor hours in general at two distinct points in the procurement process: in the proposal stage prior to the award of a contract, and in the incurred cost stage following the award of a contract. The audit procedures used differ for each stage.

When reviewing a contractor's forward pricing proposal, the auditor is required, if possible, to make a judgment regarding the reasonableness of the contractor's proposed labor hours or qualify the audit report accordingly if such a judgment cannot be made. If the contractor's proposed labor hours are based upon historical experience for other similar contracts, the auditor may be required to verify the historical data, adjust it for any differences between the requirements of prior work and the present contract, and use it to evaluate the proposed level of labor hours to accomplish the contract being priced. If, however, the contractor's labor hour estimate is based upon technical data from the contractor's manufacturing or engineering staff, the auditor may rely primarily upon Government technical representatives to determine the reasonableness of the estimate.

After a contract has been signed, DCAA has the responsibility to ensure that the labor hours charged to the contract are reasonable and allocable. Towards this end, DCAA has pioneered a "comprehensive labor audit review" concept. These labor audits depend upon a sophisticated vulnerability assessment procedure which focuses audit attention upon those contractors and contracts that are most likely to be subject to labor mischarging. The audits themselves involve the analysis of contractor employee labor charging patterns and the interviewing of contractor employees. The program has uncovered numerous instances of labor mischarging, such that 40 percent of all suspected fraud referrals made by DCAA stem from these audits alone. DCAA plans to increase effort in this area by 50 percent in the coming year.

DCAA also performs other engineering labor hour reviews in the incurred cost stage. These include regular unannounced physical observations (floor checks) of labor timekeeping practices, and reviews of engineering labor productivity, using work sampling techniques. These latter reviews are quite unique, in that work sampling procedures are usually reserved for determining factory labor productivity. DCAA believes, however, that when properly used, they can be an effective tool in determining the productivity of white-collar workers as well, and they intend to continue their use. The results of these productivity reviews are also used in the establishment of labor hour estimates for future contracts, closing the loop between DCAA's incurred cost and forward pricing audits.

7. Question. Mr. Starrett testified that the DCAA has referred fourteen cases to the Inspector General (IG) for investigation regarding General Dynamics. Please provide a list of the fourteen cases and information regarding each case.

Response. The 14 cases mentioned by Mr. Starrett were all referred to the DoD Inspector General for Investigations. By letter dated 14 June 1985, the Inspector General, Mr. Joseph H. Sherick supplied your committee with a schedule of investigations, indicating the nature of the fraud or other allegation. This schedule includes the 14 cases referred by DCAA. A copy of the letter is found in Tab B.

8. Question. The Washington Post reported on Sunday, April 21, 1985, about the results of an IG report that found that contracting officers were negotiating contracts without the required DCAA audit of the proposed pricing. It appears that there are billions of dollars of contracts slipping through with no government audits -- with the government essentially allowing the contractor to determine the fair and reasonable price. List all instances of procurements without audits in the past five years.

a. Why does this happen?

b. Has the DCAA complained about this practice? If so, to whom?

Response. The IG audit report referred to in the April 21, 1985 issue of The Washington Post stated that effective use of field pricing support would have discovered the excess profits being earned by Pratt and Whitney and General Electric. The IG report was basically addressing spare parts procurement which is a high volume activity with relatively low unit value (preponderance of procurement actions under $500,000). The response to this finding noted that field pricing reports were obtained on certain buys and excess profits were not disclosed. The report does not imply that there are billions of dollars of contracts slipping through with no government audits.

Irrespective of whether or not field pricing reviews are requested, the contracting officer must always determine that the price is fair and reasonable. In addition, when a procurement action that is based upon cost or pricing data and exceeds the dollar threshold for which a field review was not requested, the contracting officer must annotate the file justifying the action. Since this is done on a case-by-case basis and most of our 14.5 million procurements actions per year do not require field review, we do not have the information available identifying instances of procurements without audits. As detailed in our response to question 9, there are established criteria for field pricing reviews. These criteria have been designed to achieve the most cost effective use of available resources.

9. Question. Are contracting officers failing to get DCAA audits of updated data provided by the contractors during negotiations? Please explain the scope and frequency of this problem.

Response. The Truth in Negotiations Act, P.L. 87-653 (10 U.S.C. 2306(f)), requires a prime contractor or any subcontractor to submit and certify cost or pricing data for negotiated procurements under certain circumstances. Exceptions include procurements (1) based upon adequate price competition, (2) based upon established catalog or market prices of commercial items sold in substantial quantities to the general public and, (3) set by law or regulation. If a certificate is required, the contractor certifies that to the best of his or her knowledge the cost or pricing data is accurate, complete and current as of the date of final agreement on price.

Generally the contracting officer is required to request a field pricing report, which may include an audit review before negotiating any contract or modification for which cost or pricing data was required unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed cost or price.

The foregoing presents in a nutshell the current requirements for submission of data and the requirement for field review. Audits of all updated data provided at negotiations is impossible because of the contractor's continuous responsibility to update and the inability of the auditor to review such data immediately upon submission. However, at times, contractors have delayed the submission of data to the time of negotiation which would effectively prevent audit review.

In recognition of this problem, the DAR Council is currently addressing a revision to the FAR which will require the contractor to provide concurrent copies to the ACO and auditor of any information disclosed after submission of a proposal. The revision will also allow the contracting officer to request immediate review of the information and an oral report. A FAR change providing controls over waiver of audit was recently promulgated (DAC 84-12).

10. Question. What was the DCAA's role in reviewing the $544 million General Dynamics claim filed in December 1976 on the SSN 688 Class nuclear attack submarine program?

    a. If the DCAA had no role, please explain.

    b. Did the DCAA offer any protest? If so, to whom? Please supply documentation.

    c. Why did the Secretary of the Navy keep these claims away from the DCAA?

    Response. A Navy Claim Team was established and assigned the responsibility for the evaluation of the claim. The cognizant DCAA resident auditor was designated a member of the team and DCAA was requested by the Navy to price out the findings of the Navy Claim Team. DCAA issued about 30 memorandums to the team during their review. These memorandums conveyed concerns/recommendations regarding such items as changes in make-or-buy and deviations from the contractor's normal accounting system which may have had an impact on the Navy's review of the contractor's claim. An audit report applying DCAA recommended overhead and direct labor rates to the Claim Team's recommendations was issued August 25,1978.

    A DCAA memorandum dated December 15, 1976, was issued to the Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP) Contract Division (see Tab C), establishing the need for other audit evaluations in addition to applying DCAA recommended labor on overhead rates to the Claim Team's recommendations.

    As noted above, the DCAA resident auditor was designated a member of the Claims Team and DCAA did participate in the claim review process.

11. Question. In 1979, the DCAA wrote a letter to General Dynamics requesting that General Dynamics retain the passenger lists of their corporate aircraft. Notwithstanding this letter, General Dynamics continued to destroy the passenger lists.

    a. Who did the DCAA complain to at the Pentagon about this problem?

    b. Why did the DCAA not exercise its authority to stop payment on this account? Please explain.

    c. General Dynamics has received over $10 million in progress payments for their corporate aircraft between 1978 and 1983 -- despite the continued destruction of the passenger lists. Why did the DCAA put up with this?

    d. Did the DCAA know that David Lewis, the Chairman of the Board of General Dynamics, was making personal flights on corporate aircraft and charging the taxpayers about a million dollars for these personal flights? Please supply documentation.

    e. Did the DCAA refer these apparently fraudulent charges to the proper authorities? Please explain thoroughly.

    f. Are the General Dynamics claims for Mr. Lewis' personal flights considered an "expressly unallowable" cost? Please explain.

Response. DCAA requested the contractor's passenger lists on corporate aircraft flights inasmuch as they considered such records to be necessary to ascertain allowable costs under GD's Government contracts. The contractor alleged that FAA regulations did not require them to maintain passenger lists and contended that the passenger lists were destroyed. The costs were questioned and DCAA properly reported the condition to the Corporate Administrative Contracting Officer (CACO) in audit reports covering each year from 1977 to 1982. The CACO referred the matter to the Indirect Cost Monitoring Officer (ICMO) who had been researching this issue. Thereafter, the ICMO issued guidance paper No. 80-1 dated 25 August 1980. The ICMO guidance for ACO's and auditors supported the DCAA position on manifest and flight log documentation requirements.

As mentioned DCAA continued to question these costs. Finally, during March 1984 the contractor agreed to provide the passenger lists on corporate aircraft flights.

DCAA was aware that personal flights were made by Mr. Lewis. The cost of some of these personal flights were voluntarily deleted in proposals made by the contractor while the balance were almost entirely questioned by DCAA. DCAA questioned approximately $1.0 million representing personal flights of Mr. Lewis in reports covering both forecasted expenses as well as incurred cost from 1978 through 1983.

CONTINUATION OF RESPONSE TO QUESTION 11

If the auditors had encountered information indicative of fraud or other criminal activity related to the use of corporate aircraft, a report of suspected irregularity would have been issued promptly in accordance with DCAA's established procedures. The DCAA auditors did not consider the claim for corporate aircraft to be "apparently fraudulent."

Personal flights are considered to be expressly unallowable and therefore questioned by DCAA auditors. Such flights for amusement, diversion, or social activity are expressly unallowable under DAR 15-205.11 (FAR 31.205-14). The cost of personal travel is also expressly unallowable under DAR 15-205.46 (FAR 31.205-46) since the cost is not necessary, reasonable travel attributable to a contract, or incurred in the normal course of overall administration of the business. Personal travel is also expressly unallowable under DAR 15-201.4 (FAR 31.201-4) which provides that for a cost to be allocable there must be benefits received by the contract or overall benefit to the company. No benefits are obtained from personal flights. If a cost is not allocable, it is unallowable.

12. Question. We understand that General Dynamics is appealing the corporate aircraft issue to the Armed Services Board of Contract Appeals (ASBCA). Why should this even be an appealable issue when they destroyed the passenger lists?

Response. The Contract Disputes Act gives contractors the right to appeal any contracting officer's final decision. The corporate aircraft issue before the Armed Services Board of Contract Appeals (ASBCA) pertains to costs questioned regarding aircraft flights for which passenger lists were destroyed and the contractor's failure to support the need for the corporate aircraft. GD contends that even though the passenger lists have been destroyed the trips involved were acceptable expenses incurred carrying out Government contract requirements. In those cases where GD is able to demonstrate that the flight was made for acceptable business purposes DCAA has accepted the cost of the identified GD employee at commercial coach fares and questioned the balance.

13. Question. What action did the DCAA take on the last Navy contracting officer's decision in 1981 to give General Dynamics 75 cents on the dollar for the use of corporate aircraft in 1977 despite the destroyed passenger lists? If the DCAA did not take any action on the reinstatement of the 75 cents on the dollars for the aircraft costs, please explain.

Response. DCAA's mission, as stated in its charter, DoD Directive 5105.36, is to perform all necessary contract audits for the DoD and provide accounting and financial advisory service on contracts and subcontracts. Each year the DCAA audit reports identified costs considered unallowable and presented supporting rationale to the negotiator for disallowing these costs.

The fact that General Dynamics had destroyed passenger lists does not in and of itself make the 1977 corporate aircraft expense nonallocable or unallowable. The contracting officer has the authority to make the ultimate decision as to the allowability of costs on the contract. Absent indications of fraud, wrongdoing, or a continuing pattern of events contrary to the best interest of the Government, it is not DCAA's responsibility to dispute the contracting officer's decisions such as the item in question.

DCAA, in its advisory capacity, did alert the contracting officer as to the corporate aircraft problem. Shortly after the negotiation of 1977 corporate overhead, DoD implemented new procedures for following up contract audit recommendations by issuance of DoD Directive 5000.42, and subsequently DoD Directive 7640.2, "Policy ior Followup on Contract Audit Reports" dated 29 December 1982. These Directives retained the independent decisionmaking role of the contracting officer and the financial advisory role of the contract auditor, but provided for a procedure to review differences on the resolution of contract audit recommendations.

14. Question. Mr. Starrett testified that "as far as executive aircraft costs are concerned, the source of all the information related to that subject is the Defense Contract Audit Agency and our audit reports.." Is the DCAA claiming that the DCAA was aware that the personal flights made by D. S. Lewis were charged to the government? Does the DCAA think these claims were fraudulent? Why did the DCAA not turn the matter over to the DOD Inspector General?

Response. DCAA considered the personal aircraft flight expenses to be unallowable costs rather than fraudulent charges. Since the contractor voluntarily deleted the cost of some of these trips and readily conceded the cost of other trips when questioned by DCAA, there was no apparent intent to conceal these expenses. Further, they did not find any evidence to indicate that the personal trips were misrepresented in the contractor's records since they were able to identify almost all of these trips with little difficulty.

15. Question. The Subcommittee understands that the DCAA has made attempts to obtain changes in the Defense Acquisition Regulation (DAR) regarding payment for corporate aircraft charges. How long has this lack of meaningful action been going on? Has the DCAA been sufficiently forceful in this matter?

Response. Commencing in the 1970s, DCAA initiated operations audits of the economy, efficiency, and effectiveness of contractor-owned, -leased, and -chartered aircraft. Wherever reviews disclosed excessive contractor aircraft costs, the costs were questioned and DCAA recommended contractor action to reduce/eliminate future incurrences of excessive costs.

In 1978 the Air Force Contract Management Division (AFCMD), with assistance from DCAA, initiated a cost monitoring review of contractor aircraft costs. In its 20 February 1979 report, AFCMD concluded that changes were needed in the procurement regulations to strengthen the reasonableness criteria. In 1980, the Indirect Cost Monitoring Office (ICMO) recommended that Office of the Under Secretary of Defense, Research and Engineering (OUSDRE) initiate actions to (1) remove the Contractor Weighted Average Share (CWAS) designation applicable to FAR 31.205-46 (formerly DAR 15-205.46), (2) require advance agreements for all contractor segments which were allocated and reimbursed $500,000 or more of contractor aircraft costs, (3) revise FAR 31.205-46 to require flight manifests and logs documenting all flights, and (4) issue interim guidance on the allowability of costs. As a result, a DAR case to revise FAR 31.205-46 was initiated. The Cost Principles Subcommittee issued its report recommending revision to cost allowability criteria in November 1982. Due to the FAR implementation process and other priorities, the proposed revisions were not published for public comment until early 1985. DAR Council action on the case is now complete and the new cost principle language has been provided to the Civilian Agency Acquisition Council for coordination and publication in a Federal Acquisition Circular.

DCAA has consistently supported a DAR/FAR revision to clarify and strengthen cost allowability criteria. Pending such a revision, DCAA has continued to review contractor aircraft costs and, where appropriate under existing cost principles and other procurement regulations, to question unallowable, unreasonable, or otherwise excessive costs.

16. Question. It is noted that DCAA audit report, number 3201-4A140001, dated July 23, 1985, of the General Dynamics Corporation's corporate office expense allocations, contains the following notation: "We have identified several specific instances in which the contractor entertained key military personnel."

a. Did the DCAA refer this apparent violation of Federal law and DOD regulations to the DOD Inspector General or other investigative authority? Explain fully.

b. Did the DCAA advise the cognizant DOD component of this possible violation of the contract(s) with the Government? Explain fully.

c. Has the DCAA changed its procedures regarding the reporting of gratuities? Please furnish any applicable documentation. Do you consider it acceptable policy for DCAA to recommend any monetary amount as permissible for DOD officials to be entertained? Why was this done?

Response. DCAA referred the suspected gratuities to the DoD Assistant Inspector General for Investigations, in accordance with established procedures. In addition, the Corporate Administrative Contracting Officer advised the Naval Investigative Services of the suspected gratuities.

DCAA's audit report alerted the cognizant DoD component.

At one time DCAA did not report gratuities having a value of less than $20.00. This $20.00 "floor" was coordinated with the Office of General Counsel, Department of Defense. The Assistant Inspector General for Audit Policy and Oversight requested DCAA to remove the $20.00 floor. DCAA complied with the request (see Tab D). DCAA's use of a floor as described above was in no way intended to condone the acceptance of gratuities, no matter what the value. DCAA's current policy is to refer all instances of Government employees accepting gratuities to the appropriate investigative organization.

17. Question: In response to the question of when was the last time the DCAA audited executive salaries at General Dynamics, Mr. Starrett responded by stating that "the Defense Logistics Agency (DLA) was delegated the authority and the responsibility for reviewing compensation at major defense contractors about a year and a half ago."

a. When was the last time that the DCAA audited executive salaries at General Dynamics?

b. Is the DCAA saying that the DLA has taken over DCAA's responsibility for cost determinations of the reasonableness of executive salaries? What about with respect to all other compensation cost audits?

c. What audits of executive compensation did the DCAA perform prior to the transfer of this function to the DLA? Please furnish copies of all such audits conducted during the past 5 years.

d. Who directed the DLA to assume DCAA's function and under what authority?

Response: Executive salaries are routinely reviewed each year by DCAA for reasonableness, allowability, and allocability. Results of these reviews are provided in its annual Corporate Office Expense Advisory Report. The latest report was issued for CY 1982 on 23 July 1984. DCAA expects to issue its Corporate Office Expense Advisory Report covering CY 1983 by 31 October 1985.

Contractor Employee Compensation System Reviews (CECSRs) cover all compensation paid to contractor employees, both executive and nonexecutive. All organizational elements of DoD recognize that DCAA needs to maintain an active role in the determination of the acceptability of contractor costs, including compensation costs. Consequently, DCAA is the prime partner with DLA in the performance of CECSRs, and has a major role in determining the scope of the review to be conducted. Under current procedures, DCAA issues an independent report to the contracting officer, through DLA.

Under the CECSR program, DLA covers approximately 800 major contractors. DCAA maintains the responsibility for performing all compensation related work at all other DoD contractors, which number approximately 10,000 locations.

CONTINUATION OF RESPONSE TO QUESTION 17

In December 1983, DLA was officially designated as the DoD component responsible for conducting all CECSRs within the Department of Defense. Nevertheless, since 1970 DLA had been engaged in a program of performing compensation reviews at many contractors having more that $10 million of negotiated Government sales. Additionally, until 1983 a number of contractors were qualified under DoD's "Contractor Weighted Average Share" (CWAS) System. According to the Defense Acquisition Regulation, most compensation costs at CWAS qualified contractors were presumed to be reasonable. With the elimination of the CWAS concept and the formalization of DoD's CECSR Program, DCAA's role evolved as described above.

Through this entire period, however, DCAA has performed independent reviews of executive compensation at nonmajor contractors. A number of the more recent examples are found at Tab E. In addition, DCAA has continuously been responsible for reporting on the reasonableness of contractors' proposed labor escalation rates. For most contractors, large or small, this is performed on at least an annual basis. In addition, considerable time has been spent in reviewing noncash elements of compensation at large contractors, such as pension and health insurance plans, stock plans, and vacation accruals.

On 23 December 1983 the Under Secretary of Defense for Research and Engineering approved a recommendation of the Joint Contract Administration Coordinating Council to designate the DLA as the DoD Executive Agency for Contractor Employee Compensation System Reviews and Contractor Insurance/Pension Reviews. This assignment represents DoD's efforts to accent the provision in FAR 42.302 which establishes as normal contract administration functions some 61 elements of which the first one is to review the contractor's compensation structure.

Although contract administration has management survey responsibilities in the area of contractor compensation structure, DCAA has the responsibility to audit compensation costs for allowability, allocability, and reasonableness.

18. Question. Mr. Starrett testified that defense contractors have expressly unallowable costs on their books quite often. Why is the DCAA permitting contractors to put expressly unallowable costs in allowable accounts?

Response. Contractors are required to account for all costs on their books. However, the Federal Acquisition Regulation (Cost Accounting Standard 405) specifies that costs which are expressly unallowable, and those costs mutually agreed to be unallowable, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. In no way is DCAA "permitting" contractors to bill for expressly unallowable costs.

19. Question. Mr. Starrett testified that last year the DCAA had a 74 percent of cost question sustained rate in the incurred cost area. Mr. Starrett said this would include overhead. Is it not possible that the high percentage of cost question sustained rate is being affected by auditors who are reluctant to question difficult costs areas where they will not be supported?

Response. The relatively high rate of incurred cost question sustained is a reflection of the quality of both the DCAA audit findings, and of the aggressive action of the DoD procurement community who are the recipients of DCAA's report.

There is no reason to believe that a high percentage of the DCAA sustention rate is influenced by auditors' reluctance to question difficult cost areas. The quality and quantity of DCAA recommendations is closely monitored. Not only does DCAA perform regularly scheduled peer reviews such as the independent CPA firms, but my Assistant Secretary (Comptroller) through his Deputy (Cost and Audit) also performs an oversight function of this aspect of the DCAA operations. In addition to all of this, the DoD Inspector General, through his Assistant for Audit Policy and Oversight is constantly reviewing the DCAA operations to assure the validity of statistics and the quality and quantity of audit scope and coverage.

20. Question: The DCAA's access-to-records problems have been cited by the General Accounting Office and the DoD Inspector General. Why do these problems exist? How extensive are they? What has the DCAA done about correcting this situation? What is the current status? Under what circumstances will the DCAA agree to refrain from examining contractor records? Explain fully.

Mr. Starrett stated that all major DCAA offices have access to contractor unallowable accounts, including those considered proprietary and unclaimed. Do you agree with Mr. Starrett that the DCAA has access to contractor unallowable accounts?

Response: You asked, why do access to records problems exist? To answer this question, DCAA's role and responsibilities need to be explained. DCAA serves in an advisory role to the contracting officer. The nature of the auditor's work requires that he or she accumulate sufficient evidential matter in order to provide a reasonable basis for an opinion. The need for documentation frequently leads to a confrontation as to what contractor documents should be made available to the auditor. The confrontations are met and solved every day by open discussion between the contractor and DCAA personnel. If it is felt that the lack of access to certain documentation has prevented DCAA from forming an informed opinion on the reasonableness, allowability, or allocability of the costs, DCAA will withhold payment under cost-type contracts if not resolved in a reasonable time frame. If this is not persuasive, they request a subpoena from the IG. If they run into an access problem that they cannot solve while reviewing a price proposal, they so state in the audit report to the contracting officer. These qualifications are explained in the report and are addressed during subsequent contract negotiations.

DCAA's guidance on access to records states that the regional DCAA office will promptly provide written notification to DCAA Headquarters of any denial of access to records whenever (1) costs which are unsupported due to lack of access to records are questioned under price proposals or costs are suspended under cost-reimbursement type contracts, and (2) the auditor has submitted a written request to the contractor after discussions fail to gain access. Therefore, the confrontations which are met and solved every day through discussions between the contractor and DCAA personnel are not reported to Headquarters. The possible long term access-to-records problems are required by DCAA policy to be reported to Headquarters.

The Department vigorously supported legislative proposals that would give subpoena authority to the Director, DCAA; the FY 86 Defense Authorization Act, Section 938, includes a provision to this effect. In addition, effort is underway to clarify and strengthen the "Access to Records" clause.

CONTINUATION OF RESPONSE TO QUESTION 20

During the last 9 months, the denial of access to various records at 24 contractor locations has been recorded and subsequently resolved by DCAA getting access. Currently, various records at 31 contractors have been requested and access has not been obtained. Of the 31 contractors, the denial of access by 19 contractors is related to internal audit reports. Action is being taken to get the necessary access, including suspending costs at those contractor locations with cost-reimbursement type contracts. Therefore, the contractor does not gain a financial advantage by denying the Government access to records. In addition to suspending costs, DCAA has requested the issuance of an IG subpoena at eight contractors due to the denial of access to internal audit reports. Also, DCAA Headquarters is currently reviewing the possibility of issuing three more requests for an IG subpoena.

DCAA's policy is that the auditor should have sufficient access to a contractor's records on which to base an informed opinion. DCAA will not agree to refrain from examining contractor records which are necessary to the performance of the audit review. If the auditor encounters a denial of access to necessary records, steps are taken to protect the Government's interest. These steps include suspending costs and requesting an IG subpoena.

DCAA performs audit reviews in order to express an opinion as to the reasonableness, allowability, and allocability of claimed contract costs. When performing reviews of contract costs, Cost Accounting Standards are used to assess the allocability of costs. Cost Accounting Standard 405, Accounting for Unallowable Costs, addresses unallowable costs. This standard states, "Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract." DCAA is required to perform reviews of unclaimed costs in order to assure that unallowable directly associated costs have been identified by the contractor and excluded from its claimed costs. When auditors are denied access to contractors' unallowable accounts, DCAA policy requires that such instances be reported to Headquarters. We currently have no reported cases of a contractor's denial of these records.

21. Question. How many Form 1's, "Cost Questioned Disallowance" have been issued during the past five years by the DCAA? Please furnish copies of these Form 1's.

Response. DCAA Forms 1 are issued by each individual field office and no count is kept of how many forms each office issues. The form is used to suspend or disapprove contractor costs with a separate form written for each public voucher adjustment. Accordingly, one hundred or more Forms 1 could be issued for one instance of denial of access to records because of the necessity to suspend costs on all cost-type contracts affected by the denial. Examples of some DCAA Forms 1 are attached (see Tab F).

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